Social Security

Fourth Edition

Robert J. Myers

Published by

Pension Research Council
Wharton School of the University of Pennsylvania

and

University of Pennsylvania Press
Philadelphia

Library of Congress Cataloging-in-Publication Data

Myers, Robert Julius, 1912–
Social security / Robert J. Myers. — 4th ed.
p. cm.
Includes bibliographical references and index.
ISBN 0-8122-319-0
1. Social security—United States. I. Title.
HD7125.M92 1993
368.4'3'00973—dc20 92-30848
CIP

Printed in the United States of America

This book was first published in 1993. All facts and figures herein are current as of that year.

Contents

List of Tables xxi
List of Abbreviations xxvii
Foreword xxix
Preface xxxi

Part One
Introduction 1

1. Social Security Concepts 3

Quest for Security. Methods of Attaining Security. Concept of Social Security: *Types of Social Security Programs. Individual Equity and Social Adequacy. Relative Cost of Social Security versus Private Insurance. Social Insurance as "Insurance." Social Insurance as "Welfare." Necessity for Compulsory Coverage under Social Insurance Programs.* Concept of Poverty. Social Security in the United States.

Part Two
Old-Age, Survivors, and Disability Insurance 21

2. Basic Principles and Present Provisions of the OASDI System 23

Basic Principles of the OASDI System: *Benefits Based on Presumptive Need. "Floor-of-Protection" Concept. Relationship between Individual Equity and Social Adequacy. Earnings-Related Benefits. Self-Supporting Contributory Basis.* Coverage Provisions of the OASDI System: *Nonfarm Self-Employed. Farm Operators. Ministers. Employees of Nonfarm Private Employers. Employees of Nonprofit Organizations. Employees of State and Local Governments. Employees of Federal Government. Employees of Foreign Governments and International Organizations. Farm Workers. Domestic Workers. Tips. Employment Abroad. International Social Security Agreements. Military Service Wage Credits. De-*

finition of Earnings. Benefit Provisions of the OASDI System: *Insured-Status Conditions. Beneficiary Categories. Benefit Amounts. Earnings Test. Payment of Benefits Abroad. When Monthly Benefits Are Paid.* OASDI Financing Provisions: *Tax Rates. Taxable Earnings Base. Relative Magnitude of Tax Rates. Interfund Borrowing. Normalized or Advance Tax Transfers. Effect on Unified Budget. Investment of Assets.* Administration of OASDI. Income Taxation of OASDI Benefits: *Present Law and Procedures. Amounts Are Not Indexed. Examples. Effect on Child Beneficiaries. Three Anomalies. State Taxation. The Longer Run.*

Appendixes

2-1. Coverage of Life Insurance Agents on the Employee Basis under OASDI-HI 152

2-2. Procedure for Reductions in Benefits for Retirement before Normal Retirement Age for Persons Eligible for More than One Type of Benefit 154

2-3. Description of Special Age-72 Benefits 156

2-4. Detailed Descriptions of Eligibility Conditions for Auxiliary and Survivor Benefits and Initial and Final Months for Benefit Payments 159

2-5. Method of Computing PIA and MFB for Persons Attaining Age 62, Dying, or Becoming Disabled before 1979 162

2-6. Alternative Method of Computing PIA for Persons Attaining Age 62 in 1979–1983 170

2-7. Method of Computing PIA Using Wages before 1951 173

2-8. Indexing of Earnings Records, Especially as to Earnings Prior to 1978 177

2-9. Comparison of PIAs for Adjacent Cohorts and for Other Variables 186

2-10. Net Replacement Rates for Persons Retiring at Age 65 and for Young Workers Becoming Disabled or Dying 205

2-11. Detailed Description of Actual Method of Operation of Earnings Test 211

2-12. Automatic-Adjustment Procedures Applicable to Maximum Taxable Earnings Base 214

2-13. Coverage of Noncash Remuneration, Special Types of Payments, Deferred Compensation, and Salary Reductions as Wages 216

2-14. Special Method for Computing PIA for Individuals Who Qualify for Benefits Solely Because of a Totalization Agreement 226

3. Development of the OASDI System 229

Coverage: *1935 and 1939 Acts. 1946 Act. Legislation in 1948. 1950 Act. 1954 Act. 1956 Act. 1958 and 1960 Acts. 1965 Act. 1967 Act. 1972 Act. 1977 Act. 1983 Act. Legislation in 1984–90.* Monthly Benefit Categories: *1935 and 1939 Acts. 1950 Act. 1952 Act. 1956 Act. 1958 and 1960 Acts. 1961 Act. 1965 Act. 1967 Act. 1972 Act. Court Decisions in 1975–82. Legislation in 1981. 1983 Act. Legislation After 1983.* Lump-Sum Benefits: *1935 Act. 1939 Act. 1950 Act. 1981 Legislation.* Benefit Amounts: *Benefit Formulas during 1976–1978. Benefit Formula for 1979 Cohort. Delayed-Retirement Credit. Special-Minimum Benefit for Long-Coverage Individuals. Minimum and Maximum Benefit Provisions. Lump-Sum Death Payments. Computation of Average Earnings for Benefit Purposes.* Elimination of Windfall Benefits. Restrictions on Benefits Payable Abroad. Restriction on Benefits Payable to Prisoners. Automatic-Adjustment Provisions: *Opposition to Automatic Adjustments. Arguments in Favor of Automatic Adjustments. Development of Automatic-Adjustment Provisions.* Minimum Retirement Ages: *1935 Act. 1956 Act. 1961 Act. 1965 Act. 1967 Act. 1983 Act.* Benefit Proportions for Auxiliaries and Survivors: *1939 Act. 1950 Act. 1960 and 1961 Acts. 1972 Act.* Insured Status: *Fully Insured Status. Transitional-Insured Status. Currently Insured Status. Disability-Insured Status. Quarters of Coverage.* Earnings Test: *1935 Act. 1939 Act. 1947 Advisory Council. 1950 Act. 1952 Act. 1954 Act. 1960 Act. Legislation in the 1960s. 1972 Act. 1977 Act. Problems Created by Elimination of Monthly Test. Legislation in the 1980s. Analysis of Liberalization of Earnings Test.* Income Taxation of Benefits. Tax Rates: *Original Act. Legislation in the 1940s. Legislation in the 1950s. Legislation in the 1960s. Legislation in 1972–73. 1977 Act. 1983 Act. Trend of Ultimate Tax Rate. Self-Employed Tax Rate.* Allocation to the Disability Insurance Trust Fund. Taxable Earnings Base. Combined OASDI and HI Taxes. Advisory Councils on Social Security: *1975 Advisory Council. 1979 Advisory Council. 1984 Advisory Council. 1988 Disability Advisory Council. 1991 Advisory Council.* National Commission on Social Security. President's Commission on Pension Policy. National Commission on Social Security Reform and the 1983 Act: *Formation of National Commission. Functioning of National Commission. A Fair Compromise? Extent of the Financing Problem. Provisions of Legislation Enacted. Coverage Provisions. Benefit Changes. Revenue Provisions. Other Financing Provisions. New Studies Required. OASDI Problems Really Solved? Social Security as an Issue in 1984 Elections.* Legislative Procedures: *Action in the Executive Branch. Action in the House of Representatives. Action in the Senate. Final Action.*

Appendixes

3-1. Should Public Systems Withdraw from Social Security? 332

3-2. Unequal Treatment of Men and Women under OASDI: Past Developments and Status Prior to 1983 Act 340

3-3. Development of OASDI Benefit Formulas Prior to the Current Formula Based on Wage Indexing 343

3-4. The Problem of Instability in the PIA Computation Procedure Prior to 1977 Act; Various Decoupling Proposals for Its Solution 349

3-5. Analysis of Replacement Rates under 1935 and 1939 Acts Relative to Those under Present Law 361

3-6. Comparison of Actual OASDI Benefits Payable in 1975 with Those That Would Have Been Payable if Automatic-Adjustment Provisions Had Been Enacted in 1965 365

3-7. Illustration of How Automatic-Adjustment Procedure Would Have Affected Maximum Taxable Earnings Base if Enacted in 1965 366

3-8. OASDI Proposals of Reagan Administration in 1981 367

4. Financing Basis of the OASDI System 372

Why a Fund Develops: *Financing by Level Rate. Financing by Increasing Schedule of Rates. Financing by Decreasing Schedule of Rates. Pros and Cons of Increasing Schedule of Rates.* Concept of Actuarial Soundness: *Definition of Actuarial Soundness. Application of Concept to OASDI. Deficit for Present Members. Normal-Cost Basis. Valuation of Benefits in Current-Payment Status. Views of an Economist. Length of Valuation Period. Pay-As-You-Go Financing.* Actuarial Basis of OASDI: *Original Law. 1939 Act. 1947–48 Advisory Council. 1950 Act. 1972 Act. Maximum Fund Ratios for Various Past Estimates. Effect of Automatic-Adjustment Provisions. Separate OASI and DI Trust Funds. Use of Cost Estimates in Legislative Process.* Financing Basis of OASDI: *Financing Basis under 1977 Act. Projected Short-Run Financial Experience as Estimated after 1977. Projected Long-Range Financial Experience as Estimated after 1977. Congressional Responsibility in Financing OASDI.* Measurement of Actuarial Status of OASDI. Social Security and the Unified Budget. Investment Procedures: *Collection and Transfer of Taxes. Types of Investments. Alternative Possible Investment Procedures.* Relationship with Railroad Retirement System.

Appendixes

4-1. Methodology for Actuarial Cost Estimates for Social Security Programs 414

4-2. Interest Rates and Durations until Maturity of Special Issues of Investments of OASDI Trust Funds 451

4-3. Comments on Economic Assumptions in Actuarial Cost Estimates for OASDI 452

5. Directions and Issues in OASDI 454

Laissez-Faire Philosophy. Expansionist Philosophy. Moderate Philosophy. Other Factors Affecting Future Trends. Specific Directions for Development: *General Nature of the System. Views of the Public toward OASDI. Benefits. Stabilizing Mechanisms. Fail-Safe Mechanisms. Creditable Earnings Base. Earnings Test. Retirement Age. Coverage. Disability Benefits. Earnings of Married Women. Equal Treatment of Men and Women. Other Benefit-Related Areas.* Financing: *Tax Rates. Taxable Earnings Base. Government Subsidy. Taxation of Benefits.* Issues: *Who Pays the Social Insurance Taxes? Are Social Insurance Taxes Regressive? Should OASDI Be Partially Financed from General Revenues? Do Young Persons Get Their Money's Worth? Does OASDI Decrease or Increase Private Savings? Burden of OASDI-HI Taxes versus That of Income Taxes. Making OASDI Be an Instrument for General Fiscal and Economic Planning.*

Appendixes

5-1. History of the Retirement Age under OASDI and Possible Future Changes 518

5-2. Various Approaches to Provide Equal Treatment by Sex in the Computation of Social Security Benefit Amounts 524

5-3. Comparison of Actuarially Purchasable Benefits with Actual Ones 528

Part Three
Medicare 535

6. Basic Principles and Present Provisions of the Medicare System 537

Basic Principles of the Medicare System: *Basic Nature of HI. Basic Nature of SMI. Excluded Services.* Hospital Insurance Provisions: *Eligibility Conditions. Benefit Provisions. Reimbursement Provisions. Financing Provisions.* Supplementary Medical Insurance Provisions: *Eligibility Conditions. Benefit Provisions. Reimbursement Provisions. Financing Provisions.* Administration of Medicare: *Role of the Federal Government. Role of HI Fiscal Intermediaries. Role of SMI Carriers. Controls on Hospitals. Controls on Physicians (As to Quality and Quantity of Services).*

7. Development of the Medicare System 591

Early Legislative Efforts: *Legislative Proposals before 1935. Legislative Proposals between 1935 and 1950. Legislative Action in 1951–1964.* Enactment of Medicare: *Administration Proposal in 1965. Other Proposals in 1965. Action of the House of Representatives in 1965. Action of the Senate in 1965. Action of the Conference Committee in 1965.* Changes in Medicare since 1965: *Considerations and Ac-*

tions during the Johnson Administration. Considerations and Actions during the Nixon Administration. 1975 Legislative Proposals of Ford Administration. 1975 Advisory Council. Developments in 1975–1980. Recommendations of National Commission on Social Security. Legislative Developments in 1980–1984. 1984 Advisory Council. Medicare Catastrophic Coverage Act of 1988. Legislative Developments After 1984 Other than MCCA. 1991 Advisory Council. Promulgated Medicare Elements.

Appendixes

7-1. Legislative Development of Medicare Provisions in the 1967 Act 637

7-2. Changes in the Medicare Program Considered in 1970–1972 but Not Adopted 640

7-3. Changes in the Medicare Program Made by the Bill Passed by the Senate in 1973 but Not Enacted 641

7-4. Change in the Medicare Program Made by the Bill Passed by the Senate in 1983 but Not Enacted 642

8. Medicare Financing Principles and Provisions 643

HI Financing Principles: *Individual-Equity Concept. Financing and Investment Procedures. Allocation of Costs among Contributors. Self-Supporting Principle.* HI Financing Provisions: *Tax Rates. Determination of Premium Rates for Voluntary Coverage. Interrelationship of Hospital Insurance and Railroad Retirement.* SMI Financing Principles: *Premium-Rate Basis. Financing and Investment Procedures.* SMI Financing Provisions: *Determination of Premium Rates. Collection of Premiums.*

Appendixes

8-1. Methodology for Long-Range Hospital Insurance Cost Estimates 669

8-2. Methodology for Short-Range SMI Cost Estimates 675

8-3. Provisions for Temporary Government Guarantee of Solvency of SMI Trust Fund 678

8-4. Past History of Promulgations of SMI Standard Premium Rates 679

9. Possible Future Development of the Medicare Program 685

Expansion of the Medicare Program: *Coverage of Additional Types of Beneficiaries. Coverage of Unemployed Workers. Coverage of Specific Catastrophic-Cost Cases. Resurrection of Catastrophic Health Benefits Proposals. Coverage of Additional Medical Services. Long-Term-Care Benefits. Modification of Reimbursement Basis. Restructuring the Medicare Benefits Package.* Revised Financing of Medicare Program: *Introduction (or Increase) of Government Subsidy. Direct-Financing*

Provisions. Increased Cost-Sharing. National Health Benefit Proposals: *Views of Supporters of National Health Insurance. Views of the Public on National Health Insurance. Developments Following Enactment of Social Security Act. Developments Following Enactment of Medicare. NHI Proposals during 1972–1975. NHI Proposals in 1975–1978. NHI Proposals in 1979–1980. Action in Early 1980s. Catastrophic Health Benefit Plans in Lieu of NHI. Resurrection of NHI Proposals. Hawaii Health Insurance Program.*

10. Actuarial Cost Estimates and Analysis and Statistical Information for OASDI and Medicare 722

Actuarial Cost Estimates Made at the Enactment of the 1977 and 1983 Amendments: *Year-by-Year Costs. Progress of the Trust Funds. Actuarial Balances.* Actuarial Cost Estimates from the 1992 Trustees Reports: *Year-by-Year Costs. Progress of the Trust Funds. Future Fund Ratios. Historical Summary of Actuarial Balances. Projections of Covered Workers and Beneficiaries.* Effect of Varying Economic and Demographic Assumptions for OASDI Cost Estimates: *Effect of Varying Assumptions in 1974 Estimates. Effect of Varying Economic Assumptions in 1992 Estimates. Effect of Varying Demographic Assumptions in 1992 Estimates.* Past Operations: *Data on OASDI Coverage and Benefits Experience. Data on Medicare Coverage and Benefits Experience. Data on Operations of Trust Funds. Amount of Life Insurance under OASDI.*

Appendix

10-1. Actuarial Cost Estimates and Statistics for OASDI and Medicare 761

Part Four
Allied Programs 795

11. Public Assistance Programs 797

Cash-Assistance Programs for Adults: *Supplemental Security Income Program. Energy Assistance. Housing Assistance.* Aid to Families with Dependent Children: *Financing of AFDC. Statistics of Operation.* Medicaid: *Medical Assistance for the Aged. Enactment of Medicaid. Characteristics of Medicaid. Financing of Medicaid.* General Assistance. Proposed Family Assistance Plan. Relationship between Public Assistance and Social Insurance Programs: *General Relationship Principles. Data with Regard to the Relationship between Public Assistance and OASDI.*

Appendixes

11-1. Public Assistance Programs before the Social Security Act 823

11-2. Development of Federal-State Public Assistance Programs 826

12. Railroad Retirement System 833

Early Pension Developments. Initial Government Action. Coverage Provisions. Current Retirement and Disability Benefit Provisions: *Eligibility Conditions. Monthly Beneficiary Categories and Rates. Retirement and Disability Benefit Amounts. Spouse Benefit Amounts. Monthly Survivor Benefit Amounts. Other Survivor Benefits. Current Financing Provisions.* Supplemental Annuity System. Commission on Railroad Retirement Reform.

Appendixes

12-1. Outline of the Benefit and Financing Provisions of the Railroad Retirement System as Amended through December 31, 1990 851

12-2. Operational Data for the Railroad Retirement System 864

12-3. Actuarial Basis of the Railroad Retirement System 866

12-4. Development of Financing Provisions of the Railroad Retirement System 868

Appendixes

Appendix A
Definition of Social Insurance Developed by the Committee on Social Insurance Terminology of the Commission on Insurance Terminology of the American Risk and Insurance Association 877

Appendix B
Views on Individual Equity and Social Adequacy 878

Appendix C
Presidential Statement upon Signing the Social Security Act, August 14, 1935 880

Appendix D
Reporting and Promulgation Dates Specified by Law for the Old-Age, Survivors, and Disability Insurance and Medicare Programs 882

Appendix E
Funding Ratios as OASDI and Medicare Triggering Devices 884

Appendix F
Summary of Recommendations of the Social Security Technical Panel to the 1991 Advisory Council on Social Security 888

Appendix G
Summary of Recommendations of the Health Technical Panel to the 1991 Advisory Council on Social Security 891

Appendix H
Presidential Statement upon Signing the Social Security Amendments of 1983, April 20, 1983 893

Selected Bibliography 897
Index of Persons and Organizations 915
Index of Subjects 919

Chapter 5
Directions and Issues in OASDI

In considering possible future developments in the OASDI system, it may be stated broadly that there are three philosophies of what role a social security program should play in a nation's economic and social life. At one extreme is what may be called the laissez-faire philosophy. At the other extreme is what may be designated the expansionist philosophy. Between these two is the moderate philosophy.

Laissez-Faire Philosophy

Those holding the laissez-faire philosophy believe, in essence, that there should be no social security program—and certainly not on a social insurance basis. Instead, they believe that people should be completely self-reliant and take care of themselves (or have their family take care of them) when some economic risk befalls them. In our Judeo-Christian culture, this philosophy is expounded by some who believe that any unmet needs should be taken care of by private charity or, failing that, by government relief or public assistance programs, possibly involving considerable stigma to the recipients.

The laissez-faire philosophy is held by relatively few persons. Certainly before the 1980s it was not widely asserted publicly. Recently we have seen a resurgence of this philosophy. Besides the moral and ethical criticisms of stigmatizing large numbers of persons who, for one reason or another, are unable to provide adequately for themselves, this approach can often produce the opposite effect from what its advocates really desire.

If there were an extensive and fairly liberal public assistance program—which would probably occur in our highly industrialized, urbanized, politically active society in the absence of a social insurance program—many people would not bother to save through the private sector. To do so would not be productive for many persons, because any private pension or other income from savings would be deducted from the assistance payment otherwise available, and total income would not be affected. Thus, the incentive to take care of oneself would be destroyed or greatly diminished for many.

In recent years, a new laissez-faire approach has been suggested, in various, although rather similar, forms.[1] Under these, individuals would be allowed to opt out of the Old-Age, Survivors, and Disability Insurance (OASDI) system if they invest the amount of the OASDI taxes in some form of private savings or retirement plan. It is usually assumed that the person will also have the matching employer tax available for this purpose and will, it is hoped and expected, get more benefit protection than under OASDI. This approach does conflict somewhat with the pure laissez-faire philosophy, because it involves government compulsion of private savings.

The problem with this neo-laissez-faire or contractionist approach is that it would be utilized primarily by those who are low-cost members of OASDI (generally, young higher-paid workers) or who believe that they are such. As a result, the OASDI system would have a much higher cost. The advocates of this approach usually say that OASDI will then be bailed out by the General Treasury. But the main point then is that those who opt out will be in the forefront of those who must pay the general-revenues taxes for this purpose; so what do they really gain?

Expansionist Philosophy

At the other extreme are the expansionists, who believe that full economic security for those who can no longer obtain their financial support from current earnings should, for the vast majority of such

1. For examples of these proposals, see Michael J. Boskin, "Social Security: The Alternatives before Us," in *The Crisis in Social Security* (San Francisco: Institute for Contemporary Studies, 1977); Charles D. Hobbs and Stephen L. Powlesland, *Retirement Security Reform: Restructuring the Social Security System* (Concord, Vt.: Institute for Liberty and Community, 1975); and Peter J. Ferrara, *Social Security: Averting the Crisis* (Washington, D.C.: Cato Institute, 1982). A bizarre proposal of this nature was developed by Warren J. Shore in his book *Social Security: The Fraud in Your Future* (New York: Macmillan, 1975). He proposed that individuals could elect out of OASDI by buying private insurance. The insurance company then, in view of getting this business, would assume payment of benefits for life for one beneficiary on the roll for each such electing person—thus taking on a large liability, averaging perhaps $30,000 per case. Shore failed to explain how the insurance company could make sufficient money on the electing individual purchasing a policy to meet such large liability—and, if it could do so, how this would be equitable treatment or a good buy for such individual.

persons, be provided by government programs. This result would, according to this philosophy, largely be accomplished through a greatly expanded social insurance program.

Under this philosophy, the OASDI system would be extended to provide for virtually all economic needs for those affected by any long-term social risks. The benefit level would be raised such that, for the vast majority of beneficiaries, the benefit would approximate the most recent take-home pay. The expansionist philosophy of social security, if followed, would lead to the virtual elimination of private-sector activities in the economic security field. In the subsequent discussion of proposed changes in the benefit level, several examples of the advocacy of this philosophy are given—some proposing a drastic immediate change and others utilizing an incremental-change procedure.

Moderate Philosophy

The third philosophy may be called the moderate one. The moderates believe in the complementary roles of social insurance and the private sector in providing economic security for the populace. They believe that a governmentally imposed, fully expanded social security system would produce undesirable results. They take the position that full economic security provided in this manner would be bad for the character and moral fiber of the nation. This moderate philosophy holds that the level of benefits and the scope of protection should remain about the same *relatively* as at present. This would mean that benefits should be adjusted upward from time to time to reflect rises in prices and that the taxable earnings base should be similarly adjusted to reflect rises in wages.

The moderates also point out a serious related problem if the expansionist goal of providing virtually all economic security through the government sector is achieved. Such procedure would result in a significant decrease in capital formation through the private sector, because large pools of investments through private pension plans and life insurance companies would no longer develop and be available to finance economic development. In turn, this would place more and more reliance on the government to fill these capital needs. Thus, more government control of business and industry would inevitably occur.

These philosophies are by no means equal in their number of adherents or in their importance. Except between the two extreme philosophies, it is not always possible to determine exact boundaries separating them. Nevertheless, the future development of the OASDI system will be influenced by the relative acceptance of these philosophies.

Other Factors Affecting Future Trends

Other factors will affect the future of the OASDI program in addition to the conflicts among the different philosophies. Among these are such things as economic conditions, demographic changes, and public attitudes toward work and economic growth. High inflation rates, continuing without respite, could cause a steadily lessening role for the private sector in providing economic security for the populace. However, the author believes that private pension plans can be restructured to prevent this.[2]

The following demographic conditions will very likely confront the nation after about two decades—lower fertility than before 1970, resulting in relatively fewer persons at the working ages in the future than in the current population structure, plus lower mortality, resulting in a rapidly growing aged population. These obviously pose cost problems for OASDI, but they are not incapable of solution. One alleviating change would be a reversal of recent trends toward early retirement, in conjunction with the legislated deferred increase in the minimum eligibility age for full OASDI benefits as a result of the 1983 Act.

Then, too, if the public attitude toward work versus leisure and toward the desirability of economic growth moves toward the belief that stagnation is preferable, the cost effects on OASDI would be very significant. The cost of the system would be significantly higher, because of such factors as lower average retirement ages and a smaller (or even negative) differential of earnings increases over rises in the Consumer Price Index.

Specific Directions for Development

Future changes in the OASDI program will probably take various directions. New developments may occur in benefits, the maximum taxable and creditable earnings base, the earnings test, the Normal Retirement Age, coverage, the definition of disability, the treatment of earnings of married women, tax rates, and many other areas.

2. See Robert J. Myers, *Indexation of Pension and Other Benefits*, Pension Research Council (Homewood, Ill.: Richard D. Irwin, 1978).

General Nature of the System

From time to time, proposals have been made to change drastically the nature of the OASDI system. Previously mentioned in this chapter have been the proposals of the laissez-faire proponents to phase OASDI out gradually by permitting opting-out.

Other proposals have been of the "double-decker" nature—a universal flat-rate benefit financed from general revenues, plus an earnings-related benefit financed by payroll taxes. These have been suggested many times over the years. Such a plan was proposed in a study mandated by the 1977 Act for the purpose of eliminating sex discrimination under OASDI, in part by paying benefits directly to homemakers instead of paying them as spouse's benefits.[3] As one alternative, the second deck could be on an actuarially equivalent money-purchase basis, although generally this is not proposed. Incidentally, the Canadian system of old-age benefits is of the double-decker nature, with the second deck consisting of earnings-related benefits.

Those who oppose the conversion of OASDI to a double-decker basis point out the difficult, if not impossible, transitional problems. Even more important, there are major policy objections. Some have the criticism that the first deck, being financed from general revenues, might at some time be made subject to a means test.

Yet others fear that the combined cost of the two decks will not be adequately recognized by the general public. Many will see only the reduced payroll-tax rates, compared with the present ones, and then favor expansion of the second deck.

The American Institute of Certified Public Accountants (AICPA) in 1978 published a discussion paper that presents an interesting, different approach.[4] The major change proposed would be to have the benefits based entirely on a money-purchase procedure for the combined employer-employee contributions. The contributions would be indexed for price changes and would accumulate at interest (at a "real" rate of return). Because complete individual equity would be involved, benefits would be payable at age 65 without a retirement test, and various actuarially equivalent survivor settlement options would be available. For current retirees and near-term ones, the report states that "perhaps the current level of scheduled benefits should be guaranteed without a 'needs' test, but the excess of the

3. See U.S. Department of HEW, *Social Security and the Changing Roles of Men and Women* (Washington, D.C.: HEW, February 1979).

4. American Institute of Certified Public Accountants, Federal Tax Division, *Our Basic Retirement System—Social Security: Suggestions for Improvement* (Washington, D.C.: The Institute, September 1978).

amount that they receive over the amount that they would collect under the earned computation plan should come from the SSI program." In the author's view, this procedure would probably cause difficult (if not impossible) transition problems, as well as huge costs in general revenues.

An unusual feature of the AICPA proposal is that the contributions would *not* be credited to a specific trust fund, but rather would merely go into the General Fund of the Treasury. The fund would then be responsible over the years to meet the benefit obligations when they exceed contribution income on a cash-flow basis. This lack of accountability in a plan developed by accountants seems strange!

Views of the Public toward OASDI

The significant increases in the maximum taxable earnings base and in the tax rates resulting from the 1977 and 1983 Acts have produced a considerable amount of adverse criticism of the OASDI program. Many people felt, before the 1983 Act, that it was virtually bankrupt (and some still feel that way)[5] and/or that it afforded a bad financial deal, especially for younger persons. These views were perhaps engendered by a large number of newspaper articles along these lines.

Harris Survey

A better indication of the views of the American populace (although by no means a completely conclusive one) may be obtained from public-opinion surveys. One made in 1980 by Louis Harris and Associates for Johnson & Higgins (pension consultants) contained several disturbing views. Some 42 percent of current employees (somewhat over 50 percent among those aged 18–34) stated that they had "hardly any confidence" that the OASDI system would pay them benefits when they retired, while approximately another 40 percent had some confidence, but less than full. Furthermore, 41 percent of current workers and retirees lacked confidence that future working generations would be willing to pay the higher OASDI taxes necessary to support the system.

Other interesting views in the Harris survey were that 86 percent of the workers and retirees believed that OASDI benefits should continue to be adjusted to keep up to date with changes in the price lev-

5. For example, see Peter G. Peterson, "The Coming Crash of Social Security" and "The Salvation of Social Security," *New York Review of Books*, December 2 and 16, 1982; and *Social Security: From Crisis to Crisis?* (New York: Committee for Economic Development, February 1984).

els. About 76 percent were in favor of OASDI providing only a floor of protection, with supplementation being necessary from other sources. As to whether the program should be financed, at least in part, from other than payroll taxes, the respondents were almost equally divided. Only 8 percent of the respondents held what was formerly the widespread delusion that each person's taxes were being set aside in his or her own individual account to finance his or her own benefits. Some indication was given that, over the long run, people would work to somewhat later ages than had been the case in the recent past. Slightly more than half of the current workers expressed the intention of working beyond the normal retirement age, by either continuing with the same employer or getting a new job.

Harris also made several surveys on taxes and spending for the American Broadcasting Company in mid-1980. Of those having an opinion, 64 percent opposed a cut in Social Security taxes accompanied by a reduction in certain benefits (as against 55 percent being opposed to any form of tax cut). Also, as to reductions in federal spending, 76 percent opposed this being done in Social Security payments, although 88 percent favored general reductions in federal spending. The 76-percent margin against Social Security reductions was the highest of all, followed by 66 percent for defense spending, 63 percent for health care, and 63 percent for federal aid to education. Programs for which reductions were most favored were foreign economic aid (85 percent), regulatory agencies (83 percent), foreign military aid (79 percent), and welfare (71 percent).

Roper Survey

H & R Block, Inc. (income-tax preparers) had a survey taken in 1980 by the Roper Organization, Inc., on the general subject of taxes. This showed a more favorable view toward OASDI by the public. Among 15 listed national priorities, lowering OASDI-HI taxes was considered least important (only 2 percent ranking it highest); inflation and the energy supply were considered the most important. As to whether such taxes are excessive, only 24 percent of the persons paying them (and having an opinion) believed this to be the case (as against 33 percent for federal income tax and 35 percent for real estate taxes).

The Roper survey also inquired about the manner in which additional financing for OASDI should be provided. Of those who had a view, 61 percent favored allowing the scheduled tax increases to occur, 23 percent favored introducing a value-added tax (VAT) instead, and 16 percent favored reducing benefits to avoid the tax increases (but did not specify how). In another question, 80 percent opposed the complete substitution of the VAT for OASDI-HI payroll taxes.

National Commission on Social Security Survey

A detailed, extensive survey was made in late 1979 by Peter D. Hart Research Associates, Inc., for the National Commission on Social Security. This survey showed a somewhat more favorable view of OASDI than did the preceding two surveys, although it did indicate some apprehension by the general public (and also considerable lack of understanding of the program).

Among the significant findings were the following (the percentages shown are those derived after excluding the "not sure" or "unknown" responses):

1. The vast majority (79 percent) had either complete confidence or a great deal of confidence that the funds would be there to provide their retirement benefits—but only about 27 percent of those under age 45 believed so.
2. As to OASDI providing enough income by itself to meet the basic needs of retired persons versus its providing enough so that, supplemented by other forms of retirement income, basic needs were met, 70 percent recognized that the latter was the basis of OASDI, but 60 percent thought that it should be on the former basis.
3. As to the current size of the OASDI-HI taxes, 31 percent thought them too high, 14 percent thought them too low, and 55 percent thought them at about the right level—but 44 percent of those with maximum covered earnings thought them too high.
4. As to the level of various taxes, only 30 percent objected a great deal or quite a bit to the OASDI-HI taxes, versus 43 percent for income taxes, 40 percent for state sales taxes, and 61 percent for gasoline taxes.
5. As to having higher OASDI taxes or lower benefits, 81 percent chose the former, with little difference by age or income of the respondent.
6. As to having higher OASDI taxes 20 years hence or gradually raising the minimum age for unreduced benefits from 65 to 68 beginning then, only 41 percent preferred the latter. (The author believes, however, that this idea was gaining support as it was being publicly discussed, and that it would have had much less support in 1977 when it was first widely advocated.)

7. As to financing Hospital Insurance (HI) from general-revenue taxes versus increases in OASDI-HI taxes, 55 percent favored the former.
8. As to increasing OASDI taxes to finance present benefits, 65 percent favored this being done through payroll taxes, as against providing such financing from income-tax receipts.
9. As to whether, in hindsight, persons would have chosen to be in OASDI if they could have opted out, only 20 percent would rather have been out—but 31 percent of those aged 25–44 would have opted out.

The survey also revealed a considerable lack of knowledge about the program, for example:

1. Some 30 percent thought their own taxes were being individually set aside for their own benefits.
2. About 21 percent did not know that the employee tax was matched by the employer.
3. Rather surprisingly, only 50 percent knew that federal civilian employees were not covered by OASDI and 54 percent did not realize that benefits were automatically adjusted for changes in the cost of living.
4. Some 20 percent believed that OASDI benefits were paid only to those who were in need of income.
5. On the encouraging side, only 5 percent did not know that disability benefits were payable under OASDI; the same proportion did not know that there were monthly survivor benefits.

Unfortunately, no similar surveys have been taken since the enactment of the 1983 amendments. The author suspects that only time will convince the public that the financing problems of the OASDI program, both short run and long range, have been reasonably taken care of.

Perhaps the best indication of the confidence of the general public in the future of the OASDI program can be obtained from annual surveys made for the American Council of Life Insurance on attitudes to various subjects in the economic security field ("Monitoring Attitudes of the Public"). In almost every year from 1975 on, the same question has been asked about the respondent's confidence in the future of the Social Security system, using the categories of very confident, somewhat confident, not too confident, or not at all confident.

Young people who believe that the Social Security system will not be there when they retire should heed the words of President Reagan when he signed the Social Security Amendments of 1983 into law (see Appendix H).

In 1975, those who were confident (either very or somewhat) represented 63 percent of the total. This proportion declined steadily to a low of about 32 percent in 1982–84 and then rose to 52 percent in 1988 (after adjustment for those with no views). It fell to 47 percent in 1989, but then increased to 54 percent in 1990, its highest level since 1976. In 1990, the distribution of the "confident" between "very good" and "somewhat" was 19 percent and 35 percent respectively, while for the 46 percent who were "not confident," 30 percent were "not too" and 16 percent were "not at all."

The level of confidence was much lower for younger persons than for older ones. For example, in 1986 (when the overall confidence level was 60 percent) those under age 45 had a confidence level of only about 30 percent; this proportion rose to 45 percent for ages 45–54, 57 percent for ages 55–64, and 70 percent for ages 65 and over.

In the author's opinion, the confidence level currently, although properly and well advisedly rising, would be even higher if it had not been for the widespread discussion in 1990 as to "embezzlement" and "thievery" of the trust-fund assets.

Benefits

Probably the most important element from the standpoint of cost and economic effects of the OASDI program is the general benefit level. For present retirees aged 65 or over, the benefits now average about 24 percent of recent gross earnings for those with earnings at about the maximum creditable amount ($53,400 in 1991), such married retirees with wives at least aged 65 get benefits of about 36 percent of pay.

Under current law, these replacement rates for retirees at the NRA are estimated to stabilize at a level of about 28 percent for the worker with maximum taxable earnings. The corresponding figures are 41 percent for the worker with average earnings throughout the working career and 56 percent for the low-earnings worker.

Proposals to Expand Benefit Level

Over and above the changes in benefit level for those on the roll to keep it up to date with prices, there may, at some later date, be proposals for drastically raising the benefit level, possibly by as much as 50 to 100 percent, probably in gradual steps. This could be accomplished by increasing the factors in the benefit formula or by changing the method of calculating the AIME (which can be done by granting more dropout years). This would mean that, within the range of earnings covered by OASDI, workers at or below the median earnings would get benefits that would be very close to their former take-home pay. At the same time, higher-paid workers would receive not much less than their previous pay. If this procedure were followed, it could, of course, largely eliminate the function and role of private pension plans and individual savings for old age.

One example of this expansionist view is a proposal by Bert Seidman, then director of the Department of Social Security, AFL–CIO, which would roughly double the present level of OASDI benefits.[6] He would do this by providing "substantial replacement of the preretirement disposable income for all workers earning up to the median wage" (the ultimate gross replacement rate for a worker with average earnings retiring at the NRA is about 41 percent under present law—see Table 2.10). On the other hand, Seidman had previously expressed somewhat opposite views, as follows:

> Now, in the past, the labor movement generally felt that the most important steps to improve the social security system were to effect across-the-board increases in benefits plus even more sizable boosts in the minimum benefit. Overall benefit increases may be needed again at some time in the future, but that is not where we place our priority today.[7]

This might well be interpreted as meaning that OASDI benefits were at an adequate level for most workers.

Another such example is the proposal of the American Association of Retired Persons (AARP), made in 1978 and repeated later, that OASDI should be changed from a social insurance basis to a national pension program.[8] This would be done by increasing benefit levels and by eliminating social-adequacy features such as weighted benefits for the lower paid and the earnings test. The change would be made gradually (which, in the author's opinion is far easier to say than to do). The benefit level would be raised to "at least 60 percent of preretirement earnings." The financing would continue to be primarily

6. See Bert Seidman and Lyndon Drew, "The Injustices of Aging," *American Federationist*, July 1978.

7. Bert Seidman, "Concepts of Balance between Social Security (OASDI) and Private Pension Benefits," in *Social Security and Private Pension Plans: Competitive or Complementary?* ed. Dan M. McGill, Pension Research Council (Homewood, Ill.: Richard D. Irwin, 1977), p. 86.

8. See the testimony of AARP Executive Director Cyril F. Brickfield before the Senate Special Committee on Aging, September 9, 1978, in its hearings on Retirement, Work, and Lifelong Learning.

through payroll taxes, but a government subsidy would be injected when inflation and/or unemployment rates are high. In recent years, the AARP has not expressed this view.

Still another example of the expansionist philosophy—and from a high political source—is the statement (made in the form of rhetorical questions) by Joseph A. Califano, Jr., former Secretary of HEW, with regard to the respective roles of private pension plans and OASDI in a speech before the American Academy of Political and Social Science on April 8, 1978.[9]

> A critical question that affects persons all along the income scale is the relationship between private and public pensions. Private pensions have spread, so that they now cover about 45 percent of the workforce, but that growth was in a period when persistent inflation was simply not around. Even if inflation rates were cut in half, it would still call into question their ability over time to provide benefits that will keep pace with price increases. If private pension plans appear unlikely to assume a major role in providing retirement income, do we wish to continue to encourage the creation of this layer on top of Social Security? At present, we do just that—by providing substantial tax benefits for contributions to pension plans.
>
> Are we comfortable with a system in which some retirees pile up the maximum Social Security benefits on top of generous pensions, while other retirees have no pension income and find Social Security barely enough to get by on? Or would it make more sense to recoup those tax benefits and apply them to more generous and widespread Social Security coverage?

Proposals to Lower Benefit Level

Proposals have been made to change the automatic-adjustment procedure for computing benefit amounts. As indicated in Appendix 3-4, the present wage-indexing procedure, resulting from the 1977 Act, eliminated the potential danger of running out of control and producing inordinately high benefit amounts in relation to prior earnings. However, there are those who believe that the decoupling did not go far enough.

Instead, such persons advocate indexing the earnings records and the bend points in the benefit formula by the Consumer Price Index (CPI) instead of by wages.[10] Because the CPI has, in the past, gener-

9. This statement was reproduced in *National Journal*, September 30, 1978 (p. 1578), in slightly revised form (the second, third, and fourth sentences being slightly toned down).

10. See Ernest J. Moorhead and C. L. Trowbridge, "The Unresolved OASDI Decoupling Issue," *Transactions*, Society of Actuaries vol. 29 (1977) (including a discussion by the author), for an excellent exposition of the pros and cons of both approaches. A possible intermediate approach would be to index the earnings record by wages (so that the AIME would reflect real wages) but to adjust the earnings bands in the PIA formula only by CPI changes (so as gradually to lower the relative benefit level by

ally increased less rapidly than wages and is expected to do so over the long run, this will result in lower benefits in the future even though the same starting level is used. Such procedure will, nonetheless, result in amounts that have an increased real value (i.e., purchasing power). However, it will produce gradually decreasing replacement rates for new cohorts of retirees (although if the CPI were to rise more rapidly than wages—as was the case in 1979–81—the reverse result would occur, resulting in increasing replacement rates).

In the author's opinion, this is an undesirable situation, because people think of their needs in a relatively current manner, not as related to their living standards many years before. As a result, there would be politically irresistable pressures to have ad hoc increases from time to time, which might produce unduly high benefit levels (as well as being technically difficult to accomplish properly). It therefore seems undesirable to change to a benefit-computation procedure that seems certain to require change because it is very likely to be unstable, as was the procedure before the 1977 Act (although not to so great an extent). On the other hand, the present wage-indexing method is stable and has at least the possibility of not needing to be changed.

Another method of reducing the general benefit level to what some consider to be a more reasonable and financially supportable level is to index the bend points in the benefit formula by less than the full wage increase. This could be done for a limited period, after which the general benefit level would be stabilized at a lower level, or indefinitely, which would have the same undesirable results as indexing by the CPI. The 1981 proposal of the Reagan administration included a six-year period of indexing by 75 percent of the wage increase. In 1984, the Committee for Economic Development proposed that this procedure be followed indefinitely (see footnote 5).

Increase in Primary Benefits and Decrease of Spouse's Benefits

An interesting proposal has been made by Robert M. Ball, Commissioner of Social Security during 1962–73, to lessen the relative importance of spouse's benefits and thus produce more equality of treatment between one-worker and two-worker families (discussed later, in the section on earnings of married women).[11] This would be

---

having the heavily weighted band gradually become smaller relatively). This basis of complete price indexing was advocated by the Consultant Panel on Social Security to the Congressional Research Service (often referred to as the Hsiao panel, because its project director was William C. Hsiao of Harvard University)—see Appendix 3-4.

11. See Robert M. Ball, *Social Security: Today and Tomorrow* (New York: Columbia University Press, 1978), p. 251.

accomplished by not reducing any benefits in terms of dollars, but rather by holding some the same and increasing others. The full spouse's benefit would be reduced from 50 percent of the PIA to 33⅓ percent, but the general benefit level would be increased by 12½ percent. The result would be that the benefits for a husband and wife, both at least age 65, would be the same,[12] but all other beneficiaries would receive 12½ percent more. Thus, the net effect would be a significant expansion of the benefit level under the guise of remedying or alleviating the discrepancy between the one-worker family and the two-worker family.

Increase in Benefits at Older Ages

Mr. Ball has also proposed that all benefits should be increased by 10 percent at age 85. This would be done in recognition that many persons at such ages require special attention or services. This, however, is only so on the average; some may have much greater needs, and others none at all. Also, needs-tested programs such as SSI can provide for such needs.

Increase in Lump-Sum Death Payment

A final benefit-related suggestion which some have made is that the maximum amount of the lump-sum death payment (which has been unchanged since 1952) should be increased to recognize the changes in the price and wage levels over the years. On the other hand, in 1979, President Carter recommended the immediate elimination of this benefit, but in 1980 he dropped this recommendation. Legislation in 1981 limited this payment to surviving spouses living with the deceased worker or to the surviving spouse or children if eligible for immediate monthly benefits.

Changes in Automatic-Adjustment Provisions for Those on the Roll

Several proposals have been made with regard to the automatic adjustment of benefits for those on the roll. Some have suggested that such adjustment should be made more frequently than annually when inflation is high. Others have proposed that the adjustment should be on the generally more liberal basis of wage changes, instead of price changes, to reflect changes in living standards of the working

12. Thus, for a present PIA of $400, the family benefit is $600. With a 12½ percent increase, the PIA would become $450, and the spouse's benefit at 33⅓ percent would be $150, so that the family benefit would still be $600.

population. On the other hand, some have argued that the CPI overstates real price changes, so that only a portion of the CPI increase should be recognized, or else the CPI should be revised to be more accurate and meaningful. Still others have proposed that a special CPI be developed for the aged or for OASDI beneficiaries. There is some question as to whether this would result in larger or smaller increases in benefits than would the general CPI.

Proposals have also been made to base the COLA on the percentage increase in the CPI, *minus* a certain number of percentage points (e.g., CPI minus 2 percent); this financially powerful and effective procedure has often been suggested in connection with efforts to reduce general budget deficits (when OASDI was in the unified budget), rather than solely for OASDI program purposes (although obviously it would have a significant effect on slowing down increases in costs, as well as adversely affecting beneficiaries). This procedure is still recommended by those who wish to reduce the overall level of government expenditures. However, if this were done there would be equal logic in reducing payroll taxes (because of the lower program costs involved), so what would be gained from a budget standpoint?

Stabilizing Mechanisms

Some proposals have been made which would help to stabilize the financial status of OASDI when adverse economic situations occur. One of these is basing the COLA on the lesser of CPI increases or wage increases. Additionally, there would be a "catch up" after a lower increase than the CPI had been given and then wages rose more than the CPI; under these circumstances, the portion of the CPI increases which had been withheld would be "repaid." This procedure was introduced in the 1983 Act, but with such a low trigger point for determining when the fund balance is "low" and the procedure becomes operative that it is not as effective as it might be. A trigger point which is at, say, a fund ratio of 50 percent (rather than 15 percent in the near future and 20 percent ultimately) would be a much more effective stabilizing device.

A better stabilizing mechanism was considered at length by the National Commission on Social Security Reform in 1983—and, although looked upon favorably by a number of members, it was not contained in the consensus package, which was hastily agreed upon at the last moment. This mechanism was simply to base the COLA on the percentage increase in wages, *minus* 1½ percentage points (rather than on the CPI).

The logic behind this proposal was that the long-range economic assumption in the intermediate-cost (Alternative II-B) estimate at that time (although currently only 1.1 percent) was that wages would increase 1½ percentage points more than the CPI. As a result, if the experience matches the assumptions, the effect of the proposal would be exactly the same as using the CPI. Thus, the long-range cost estimates would show great stability under all assumptions as to economic conditions.

If the real-wage differential is actually less than 1½ percent, the COLAs would be smaller than under the present basis, and the increased deficiency which would be shown under the present basis under these economic conditions would be significantly reduced. Conversely, if the real-wage differential is actually more than 1½ percent, the beneficiaries will receive larger COLAs than under the present basis, and the increased surplus resulting from such economic experience which would arise under the present basis would meet the cost of such larger COLAs.

Fail-Safe Mechanisms

Although the stabilizing mechanisms just described (particularly the last one) would do much to assure the financial viability of the OASDI Trust Funds in case of poor economic conditions, they would not necessarily assure that. Various fail-safe mechanisms could be provided which would give almost complete assurance.

One such procedure would be an automatic-adjustment provision that would operate when the trust-fund balance is low (desirably with a sufficiently high trigger point) and would reduce or even eliminate the COLAs until an adequate balance is built up. The Senate version of the 1983 Act contained such a provision (with a trigger point of a fund ratio of 20 percent), which was sponsored by Senator Russell B. Long (Louisiana, Democrat). However, this provision was dropped in the conference between the House and the Senate.

Another procedure would be similar to the previous one except that an increase in the tax rates would be triggered when the fund balance is low. In between these two procedures would be a triggering of both a COLA cut and a tax-rate increase; this could be arranged so that half of the needed additional financial resources would come from a COLA cut and the other half from a tax-rate increase.

Creditable Earnings Base

Closely related to the question of the benefit level is the maximum earnings base subject to taxes and creditable for benefits. This is an area of great controversy. One school of thought argues for the maintenance of this maximum base at the same relative level as it was in 1974–78, before the three sizable ad hoc increases in 1979–81 were legislated by the 1977 Act, and as it would be automatically adjusted thereafter in accordance with changes in the general wage level. Others argue that the base should be decreased somewhat, or not be allowed to increase for a few years, so that it would maintain the same position as it held when the base was changed to $3,600 in 1951, $4,200 in 1955, $4,800 in 1958, $6,600 in 1966, $7,800 in 1968, and $9,000 in 1972. Those bases covered the full earnings of about half the regularly employed male workers—or, viewing it from another aspect, about 80 percent of the total payroll. As earnings rise in the future, according to this theory, the maximum base would be raised from time to time in a proportionate manner, as done in 1951–72.

The other school of thought, which prevailed in the 1977 Act, would increase the earnings base applicable to workers such that virtually all except the very highest paid would have all their earnings covered, as was the case with the original $3,000 base in the late 1930s. The required comparable base would, in 1984, have had to have been $43,500 (as against the $37,800 actually in effect). Thus, this goal of the expansionist philosophy has virtually been attained, if the law as it is in this respect following the 1977 Act is not amended.[13] Such a proposal, when interrelated with that for a sizable increase in the benefit level, would mean that virtually all workers could derive sufficient economic support from OASDI so that little supplementary savings for old age, either on a group or on an individual basis, would be necessary—other than perhaps homeownership.

Earnings Test

Another important area where changes may occur in OASDI is in the earnings (or retirement) test. If public opinion on desired changes were measured by the number of bills introduced in Congress, the popularity leader by an overwhelming margin would be the repeal or liberalization of this test. Before 1975, the congressional committees

13. At one point in its deliberations, the 1975 Advisory Council on Social Security recommended increasing the earnings base to $24,000 for 1976, which would be equivalent to about $35,000 in 1981 (based on the actual increases in wages in 1977–81), or well above the $29,700 established by the 1977 Act. This action was taken merely to provide additional financing to bolster up the deficiency of OASDI. Later, this proposal was rejected, when it was realized that the level of the earnings base plays such an important role in the extent to which the private sector can provide part of the economic security for the people of the nation. It is interesting that the labor movement at that time opposed such a sharp increase in the earnings base. Bert Seidman, at that

responsible for OASDI legislation recommended only moderate changes in this provision (largely, to keep the dollar figures in it up to date with changing earnings levels—as the automatic-adjustment provisions will do in the future), apparently recognizing that most of the public criticism has been due to misunderstandings. Furthermore, most interested national groups, such as labor organizations and business associations, have always strongly favored such a test.

Justification for the Earnings Test

The major reason for the earnings test is that the OASDI program is designed to provide benefit protection against the presumed loss of earnings arising from the risks covered by the program. This basis, insofar as retirement benefits are concerned, naturally differs from private insurance, which necessarily provides annuities at a prescribed fixed age. However, it is not greatly different than private pension plans, which invariably pay retirement benefits only upon cessation from work covered by the plan. The test is a condition of eligibility for benefits and is not a prohibition of benefit payment (or, for that matter, a prohibition against working).

Cost considerations are also important in connection with the earnings test. The cost of eliminating it is substantial—an increase in the rate of current outgo of about $10 billion a year. However, over the long range, the cost increase is not large, because when the DRC becomes 8 percent per year, from a cost standpoint the test has been eliminated for persons at and above the NRA.

Paying benefits to fully employed persons is not socially necessary. On the other hand, paying partial benefits or even full benefits to those in part-time or low-paid employment seems desirable. The improved earnings test provided by the 1972 Act goes a long way toward eliminating inequities and anomalies. It provides some incentive for aged persons to engage in partial employment and to taper off as they become older. Further, the changes made in the 1983 Act (the smaller rate of reductions for "excess" earnings and the larger DRCs) provide more work incentives.

Another argument that has been made in favor of having an earnings test is that, without it, wage levels might be depressed. The

time the social insurance expert of the AFL-CIO, has said that such a move is not justified "now or even a long time in the future," although he stated that there might be a need for a gradual rise (AFL-CIO, Labor News Conference, January 15, 1975). He went on to propose a government subsidy to solve the financial problems of OASDI. However, when the legislation underlying the 1977 Act moved in this direction, no strong objections were heard from the AFL-CIO.

theory underlying this argument is that persons beyond the NRA who receive OASDI benefits would be willing to take lower wages than the going rate applicable to workers with no other source of income.

Arguments against the Earnings Test

Those who argue for the elimination of the earnings test do so on four grounds.[14] First, they assert that the taxes plus accumulated interest belong to each person individually and purchase his or her own benefits, so that they should be paid beginning at the NRA, and the system should not "profit" by the person continuing to work and not getting benefits. This point is countered by the fact that the taxes are not accumulated on an individual-equity basis and that the risk insured against (and for which the financing under the tax schedule in the law is developed) is the risk of retirement after the NRA. Admittedly, the underlying philosophy on which this argument is based is violated to some extent by the test not applying at and after age 70, which was the result of political compromises.

Second, the argument to eliminate the earnings test is made on the grounds that people would thus be encouraged to work and that they need the additional money to have enough to live on. Countering this is the fact that only about 10 percent of those over age 65 now have any significant earnings at all, and many of these earn less than is permitted for receipt of full benefits. It would seem that many aged persons who cannot be gainfully employed use the earnings test as perhaps an unnecessary alibi to explain their not working.

Moreover, if it is true that some people need substantial earnings to supplement their OASDI benefits to live on, then it would seem that the entire benefit level is too low for the vast majority of the aged who cannot work at all.

As part of the foregoing argument, it is asserted that the earnings test is a strong disincentive to employment for persons who are eligible for OASDI benefits. This is true for some individuals—those who have earnings possibilities to well exceed the annual exempt amount—but not for those who have such high earnings that the loss of benefits is not important.

However, for some persons, strong disincentives are present. Consider an unmarried individual aged 65–69 who, in 1991, can obtain

14. For a vigorous exposition of this viewpoint, see Senator Barry Goldwater's article "This Law Robs Our Senior Citizens," *Reader's Digest*, August 1974, which was discussed in Chapter 2 in relation to the underlying nature of the OASDI taxes and the resulting individual-equity versus social-adequacy aspects thereof.

$1,000 of additional wages above the annual exempt amount, and who is in the 28-percent federal income-tax marginal bracket (with a net state income-tax rate of 4 percent). The $1,000 of wages is reduced by (*a*) $76 of OASDI-HI taxes, (*b*) $280 of federal income tax, (*c*) $40 of state income tax, and (*d*) $333 less OASDI benefits. Thus, the net increase in income is only $271, so that it might be said that the individual's earnings were subject to a "tax" of 72.9 percent. The situation would be somewhat worse if self-employment (with the higher OASDI-HI tax rate), rather than wages, were involved. However, it would be somewhat better if the individual had sufficiently high unearned income (including tax-exempt interest) such that the OASDI benefits were partially taxable—because then there would not be the partial substitution of income-taxable earnings for fully nontaxable benefits.

As an offset, when benefits are withheld due to additional earnings, then future benefits will be larger because of the Delayed-Retirement Credits resulting—and also possibly because the earnings might be high enough to increase the average earnings used in the benefit computation.

Third, it is argued that the earnings test is unfair because it does not take into account unearned income, such as private pensions and investment income. To do so would change the nature of the OASDI program from social insurance to public assistance. Moreover, such a change would probably have the opposite effect of what advocates for the elimination of the earnings test would want, because the result would be far less private savings. Unless one could amass a very large income from private savings or private pension plans, why would one want any private-sector income, because it would only result in a reduction in the OASDI benefit payable?

Fourth, advocates of eliminating the earnings test deny that such action would have the high cost stated. They assert that, after elimination, many people would work far more and would pay more OASDI taxes and more income taxes, too. In the author's view, this effect would be relatively small and really of no relative significance. As indicated previously, relatively few persons over age 65 who are not now working seem to have the possibility of doing so under any circumstances. Even for those few now working, not many seem to restrict their earnings so as to fall just below the maximum allowable for full benefit receipt.

Several ways have been proposed to solve or lessen the "problems" associated with the earnings test, without eliminating it completely. The 1-percent Delayed-Retirement Credit inaugurated in the 1972

Act and the 3-percent one in the 1977 Act for those attaining age 62 after 1978 were enacted for this purpose.[15] Some persons advocated increasing the rate from such a "niggardly low" level. If such rate were to become as high as 8 to 9 percent, it would have the same cost effect as if the earnings test were eliminated. In other words, the increment would then be at the actuarial-equivalent level. The 1983 Act moved very considerably in this direction by increasing the rate to 8 percent (eventually, for persons attaining the NRA in 2009 and after). Thus it could properly be argued that, in 20 years, the retirement test will, in fact from an actuarial standpoint, be eliminated.

Proposed Liberalizations of the Earnings Test

Still another proposal along these lines to soften the "inequity" of the earnings test is to eliminate the employee tax after the NRA. The "logic" of this is that the persons affected should not be penalized twice—by paying taxes and by not receiving benefits. This approach ignores the fact that the taxes paid "purchase" larger eventual benefits through the DRC and often through higher average earnings for benefit recomputation purposes.

Another possible liberalization of the earnings test would be to reduce the proportion of benefits withheld for earnings in excess of the annual exempt amount. Such reduction could, for example, be only $1 of benefits for every $4 of excess earnings, or even $1 for every $5. This could be done for all such excess earnings or for only a band thereof. Some people view this proportion as a "tax" on such excess earnings and assert that the present basis is like a 50-percent tax rate, which is unduly high. Again, the 1983 Act moved in this direction by changing the reduction to a "$1-for-$3" basis in 1990 and after for persons who have attained the NRA.

The problem with this change is that it results in paying partial benefits to persons with high earnings who have by no means retired. For example, consider a husband and wife both over age 65 with a family benefit of $1,500 per month. If the annual exempt amount is $10,800, and the proportion is $1 for $4, then some benefits would be payable as long as annual earnings are less than $82,800. This would seem peculiar and illogical to many people.

The earnings test could also be liberalized by reducing the limiting age from 70 to some lower age, such as the NRA (as in the House-passed version of the 1977 Act). Or else the annual exempt amounts

15. But note that most of the increase from 1 percent to 3 percent was made, not for this reason, but rather to compensate for the effect of the wage-indexing method (see Chapters 2 and 3).

could be increased more than the automatic-adjustment provisions would do. Also, the differential in the exempt amounts between those at the NRA or over and those under such age (as introduced by the 1977 Act) might be eliminated.

Professor Peter Diamond of the Massachusetts Institute of Technology has made an interesting proposal with regard to the earnings test (as mentioned in the report of the 1979 Advisory Council on Social Security, but not recommended by that group). The principle would be to pay increasing fractions of the benefits from ages 65 to 70 in an automatic manner regardless of earnings—namely, 15 percent at age 65, 30 percent at age 66, 45 percent at age 67, 60 percent at age 68, 75 percent at age 69, and then (as in present law) 100 percent at ages 70 and over.

Another suggested change in the earnings test is to vary the annual exempt amount in relation to the PIA. One such approach would be to have *higher* exempt amounts for *larger* PIAs, the theory being that this would more truly measure the relative extent of retirement of the individual. On the other hand, there is the approach of having *higher* exempt amounts for *lower* PIAs—to "permit" more total income for the beneficiaries with small benefits. Either of these approaches would be difficult to administer.

Perhaps the best and most reasonable solution to the problems involved with the earnings test—particularly the disincentives to work that it creates for persons with earnings of between 50 percent and 150 percent of the average wage—would be to increase immediately the Delayed Retirement Credits to 8 percent per year. After all, this level for the DRCs is scheduled for those who attain the Normal Retirement Age in 2009 and after, so why not do it now? From the viewpoint of cost and actuarial equivalence, such action would, in effect, eliminate the earnings test at the NRA and above, and thus its disincentives to work after the NRA. Along with this, an intensive educational campaign should be instituted so that people affected realize that they will be equitably treated if they defer claiming benefits while working after the NRA and will then have a better preretirement and postretirement income pattern (and also possibly lower income taxes than if they received both benefits and earnings while working after the NRA).

Retirement Age

Although it is generally stated that the "normal" retirement age—that is, the earliest age at which unreduced benefits are available—is 65, OASDI has no single "retirement age." For example, considering the present situation of the NRA being 65, it can correctly be stated that a full benefit is payable at age 62 (in the amount of 80 percent of the PIA) and that increasing amounts are payable for later retirement—namely, 125 percent of the age-62 benefit at age 65 and 143.75 percent at age 70 (i.e., 115 percent divided by 80 percent). Conversely, it could be mathematically expressed that the full benefit is payable at age 70 (in the amount of 115 percent of the PIA) and that reduced benefits are payable for retirement before then—namely, 87.0 percent of the age-70 benefit at age 65 and 69.6 percent at age 62.

The minimum retirement age, too, is a matter of considerable significance. Just as in the case of the earnings test, there had, in the past, been strong popular pressure for lowering this age. From a logical standpoint, considering the improvements in health conditions and the decreased mortality of aged persons that have occurred in the past and are likely to occur in the future, it could well be argued that the retirement age should be gradually increased in the future. This has been done in a few countries, even though it is politically difficult.

Increasing the Retirement Age

Although the 1983 Act provided that, in a deferred gradual manner, the NRA would be increased from 65 to 67, it is not impossible that further such action might occur, especially if significant breakthroughs occur in the field of medical care for the aged. The change in the mid-1970s from 65 to 70 in the minimum mandatory retirement age that employers can impose under the Age Discrimination in Employment Act may be considered a small move in this direction. Such a change in the NRA under OASDI could greatly lessen its financial burden after the turn of the century, part of which arises from the projected future demographic trend of lower fertility. Appendix 5-1 presents an extensive discussion of the history underlying the NRA under OASDI and the arguments in favor of changes in the future.

Reducing the Retirement Age

Nonetheless, looking back some years, the trend seemed to be somewhat in the opposite direction. The minimum retirement age for men was reduced to 62 by the 1961 Act, but with actuarially reduced benefits. The strength of this movement to lower the minimum retirement age arose from the fact that, in certain areas of the country, there were relatively high levels of long-term unemployment among workers just below age 65, in large part because of automation, and this situation was not covered by the unemployment insurance program.

Furthermore, as the argument goes, making this change had no cost effect on the program, and providing for a lower age than 62, with appropriate actuarial reduction, would also have no adverse cost effect on OASDI. Underlying this argument is the thought that making available reduced retirement benefits at an earlier age will not generally result in voluntary early retirement or in changed employer retirement policies. If such is not the case, however, there could be very significant effects on our national economy through loss of production by having a reduced labor force, so that the absence of OASDI cost considerations may not be the controlling factor.

In the event of high levels of unemployment at the older ages, there may be pressures to lower further the minimum retirement age and, at the same time, to reduce or even eliminate the actuarial-reduction factors. This may be necessary so that benefit adequacy will not be too greatly decreased. The higher cost of the system would, of course, have to be met from the national product in the form of higher taxes from covered workers and employers (either directly in the form of payroll taxes or indirectly through other taxes if a government subsidy is provided to meet the added cost). It can be argued that this is feasible, as well as equitable, because increased productivity can absorb this cost and should be used first for this purpose.

Proposals to Increase the Retirement Age

Nonetheless, in the past two decades, there were moves to raise the minimum retirement age for full-rate benefits from 65 to 68 or 70. Both the 1975 and 1979 Advisory Councils on Social Security suggested that this should be considered, although they did not positively recommend it. The bill proposed by the Republican members of the House Ways and Means Committee during the consideration of the 1977 legislation would have raised such age to 68 (and at the same time eliminated the earnings test after that age).[16] It is most important to note that such proposed increases would not be immediate and sudden, but rather would be phased in (three months' increase per

16. Specifically, the minimum retirement age would have remained at 65 until 1990. Then, for those attaining age 62 and 3 months in 1990, this would be the required age. This procedure would be followed until, for those attaining age 68 in 2001, the requirement would be age 68. A later modification of this proposal would have started the phasing-in 10 years later.

calendar year) beginning some years hence. This would give persons affected ample notice so that they could make appropriate retirement plans. In 1980, both the National Commission on Social Security and the President's Commission on Pension Policy strongly supported such a change. The former also recommended increasing the early-retirement age in tandem, so that it would eventually become 65.

The 1983 Act increased the NRA for workers to age 67 (effective for those attaining such age in 2027), beginning the change for those attaining age 62 in 2000. The change was only to age 67 and the transition was over so many years solely because the resulting savings in cost (according to the intermediate-cost estimate) was just sufficient to put the program into long-range actuarial balance; in essence, this was the last element to be considered in regard to the long-range financing of the program. The early-retirement age was left at 62—to give the appearance that this option was not "taken away," but the reduction factors were changed so as to continue to be "actuarial."

Eligibility Age for Widows

There may also be developments in the direction of lowering the minimum eligibility age below the present age-60 limit for widows and widowers who do not have eligible children in their care. The problem is particularly serious for those widowed at older ages or those whose last child ceases to be eligible when they are not quite old enough to qualify for widow's benefits. Proposals have been made from time to time to lower the minimum eligibility age, or to provide for a continuation of mother's benefits after the last eligible nondisabled child has reached age 16, or to pay temporary "adjustment" benefit for one year for all young widows. These proposals, however, involve both significant cost considerations and matters of equity and consistency in comparison with the situation for women workers, who must wait until age 62 to be eligible for benefits.

Coverage

Probably all students of social security, whether they be of the moderate or expansionist philosophy, believe that all gainful workers should be covered under OASDI if at all administratively feasible. Over the years since the system began in 1937, through one means or another, this goal has now been virtually achieved. This has also been recommended, directly or indirectly, by all advisory councils on social security and by a number of other study groups.

At present, the only significant categories of workers not covered are civilian employees of the federal government who were hired before 1984, some state and local government employees, low-paid or very irregularly employed farm and domestic workers, low-earning self-employed workers, and unpaid family workers. From one viewpoint, railroad workers are not covered under OASDI because of the existence of the separate Railroad Retirement system. But in fact, from a financing standpoint and, to a considerable extent, from a benefit standpoint, they really are covered under OASDI by reason of tier 1 of the RR system (see Chapter 12).

Coverage for Low-Income Workers

The low-income groups of farm and domestic workers and self-employed persons who are not covered are relatively small. Administrative difficulties seem to preclude any attempt to extend coverage further to these categories. The author believes that, in actual practice, even present coverage compliance and enforcement are not nearly complete and that the federal government is not doing all it really should to obtain the complete coverage under present law.

Also, in a real sense, coverage of these groups will automatically be extended in the future as general wages rise. The fixed-dollar requirements for coverage mean that a growing proportion, asymptotically approaching 100 percent, will be covered over the years. For example, in the domestic-worker area, coverage depends on having at least $50 of wages from the particular employer in a quarter. In the mid-1950s, this generally represented about 10 days of work, while now it is often only about one day in some localities, so that even the most casual workers should be covered.

Coverage of Federal Employees

When the Social Security program was first developed, the case for OASDI coverage of federal civilian employees under a retirement system was the clearest of all. There are no constitutional or administrative problems whatsoever. The need for such action was obvious—some federal employees would have gaps in their OASDI coverage and thus reduced OASDI benefits, with no corresponding benefits from a government retirement system if they have short, intermittent fedeal service, while others could receive overly large dual benefits.

The logic for such coverage of government employees under

OASDI is clear. If the government requires private employers to be under OASDI even if they have an adequate pension plan of their own, why should not the government do the same thing with respect to its own employees? But the practical political facts of life are such that coverage of those hired before 1984 probably cannot be achieved. The unions and other organizations of federal workers are strongly opposed to such coverage, largely because of the dual-benefits windfall that, in the past, was taken advantage of by many long-service workers and because such organizations would have less influence in the fringe-benefits area if part of the protection were transferred to OASDI. Because of this employee pressure and the complications of developing a coordinated plan for current employees, the only politically practical solution in the 1983 Act was to cover only new entrants in the future, for whom a revised retirement system would also be applicable.

The 1983 Act further ameliorated this windfall problem by a provision which largely eliminated the heavy weighting in the PIA benefit formula for persons with pensions from noncovered employment who have relatively short periods of OASDI coverage. This, however, was done only for persons first becoming eligible for benefits after 1985 (and then in a gradually phased manner).

Coverage of State and Local Employees

About 30 percent of all employees of state and local governments are not now covered under OASDI, because their employing units have not elected to be covered or because the employees themselves do not want to be covered (for the same reasons as for federal employees). Now, as a result of legislation in 1990, all such noncovered employees have coverage under a retirement system of their government unit. One possibility would be to cover only new hires (as was done for federal employees).

Constitutional reasons, in some persons' views, prevent the federal government from compelling these government units to be covered under OASDI (although it was thought possible in the 1983 Act to prohibit existing covered entities from withdrawing and in 1990 legislation to cover compulsorily all such employees who are not under a retirement system).

One way to extend coverage completely to state and local government employees exists. It would be perfectly legal and constitutional to cover (and tax) compulsorily all such employees directly (as is done for personal income tax). The tax rate could be at the self-employed rate. There are precedents for this (namely, ministers and Americancitizen employees of international agencies and foreign governments working in the United States).

Congressional Action in 1977

During the legislative activity that preceded the 1977 Act, the House Ways and Means Committee developed a provision that would have provided compulsory coverage of all federal, state, and local employees and of all nonprofit employees who were not already covered. This, however, was rejected by the full House of Representatives. The final bill merely contained provisions for a further study of the matter, and this undoubtedly was one element leading to the extension of coverage to new federal hires in the 1983 Act.

Alternative Action in Lieu of Coverage of Government Employees

Yet another course of action to prevent or at least reduce the windfalls for these groups would be to place restrictions on the benefits (beyond what was done in the 1977 Act by freezing the amount of the minimum Primary Insurance Amount (PIA) and by the government-pension offset provision applicable to benefits for spouses). For example, the PIA for an individual with dual coverage under OASDI and a government-employee plan which does not also have OASDI coverage would be computed as the excess of the PIA based on the combined earnings record in such government employment and the actual covered employment over that based solely on covered employment. This would have the effect of largely eliminating the windfall arising from the heavily weighted nature of the OASDI benefit formula.[17] Another approach would be to determine the PIA as the product of (1) the PIA based on the combined earnings record and (2) the ratio of actual total covered earnings to total combined earnings (both sets of earnings being indexed). Under either alternative, the noncovered government earnings should probably include only those *after* the effective date of the new basis.

The 1983 Act contained a different approach than the foregoing ones. Specifically, as described in Chapter 2, a smaller benefit factor for the lowest earnings band in the PIA formula is used, but with the proviso that the reduction will not be more than 50 percent of the pension based on noncovered services after 1956 (applicable to all such services and not merely to those for a governmental entity).

17. Such a procedure is followed under the Railroad Retirement system (see Chapter 12).

Coverage of Other Categories

Persons engaged in unpaid family work (defined as employment in work other than maintaining and operating the home, usually work on small farms) are relatively few in number. There seems to be no great problem here, especially because many so involved are either children who have no need for current coverage and will, in any event, very likely be covered in other employment when they become older, or wives who will have benefit protection through their husband's earnings record (other than disability protection and survivor protection for their children). Note that coverage has been extended to all persons who are bona fide employees of their spouse.

Earnings Credits for Homemakers

With the growing impact of the women's liberation movement, a new approach in the area of OASDI coverage has been suggested. Earnings credits (on which OASDI taxes would be paid) would be made available to all homemakers. This could involve either voluntary individual coverage election (which would have problems of antiselection) or compulsory coverage (which would entail significant administrative problems of compliance enforcement). The amount of the presumptive earnings to be credited and taxed could be either uniform for all (which would lead to problems as to the proper level at which it would be set) or optional, depending upon individual choice (which would have problems of antiselection).

Blanketing-in of Uninsured Persons

Another type of change that was talked about for many years is the so-called blanketing-in of persons aged 65 or over (or, alternatively, aged 72 or over) for the now-repealed regular-minimum OASDI benefit (or some other flat amount). This was argued for on the ground that this group had been treated unfairly in contrast to the many beneficiaries who had received benefits based on covering earnings but, from an actuarial standpoint, had "purchased" only a small proportion of their benefits. On the other hand, the proposal was opposed on the basis that it would destroy the incentive to extend and maintain contributory coverage, because some groups (such as farm and domestic workers) might prefer not to contribute, and yet they would receive the minimum benefit.

The financing of the blanketing-in proposals would be accomplished by several alternative procedures—completely from the funds of the OASDI system, completely from the General Treasury, or partially from each of these sources. One such dual-financing basis would have the General Treasury make a lump-sum payment with respect to each blanketed-in person that would equal the maximum cumulative combined employer-employee contributions that would have been paid with respect to a person receiving the minimum benefit, plus compound interest. Some persons strongly opposed any such financing that relied in whole or in part on payment by funds of the OASDI system, on the grounds that this would be a "raid" on the trust funds and would destroy the basic contributory principle.

The arguments in favor of a permanent blanketing-in of the uninsured aged became less strong as time went by, because the group involved had decreased steadily in numbers. The blanketing-in of persons who became age 72 before 1968 for a lower-than-minimum benefit as a result of the 1966 Act was a step in this direction, but it seems most unlikely that this will be extended to other than the closed group involved.

Another form of blanketing-in is the "double-decker" approach. All persons meeting the age requirement (and also a residence or citizenship one) would be eligible for a flat monthly benefit which would be financed from general revenues. The second deck would be an amount directly proportional to average covered earnings (i.e., the AIME). Those who advocate this approach believe that it would clearly separate the "welfare" and "insurance" elements. As indicated previously, the present OASDI program essentially does this for all persons with covered earnings, and the author believes that those who take this position do not really understand the concepts involved (see Chapter 1).

Disability Benefits

Another type of change is in connection with the definition of disability, which is now very strict and involves a waiting period that is, in practice, about six months. Proposals have been made that the definition should be changed from the present basis to an "occupational" basis—at least for those at the older ages (50 or 55 and over). The occupational basis would be either with regard to the last regular occupation or, more strictly, for inability to engage in substantial gainful activity requiring skills or abilities comparable to those required in a past activity in which the person had engaged with some regularity over a substantial time period.

Over the years, there has been pressure to provide special benefit features for the blind. This has resulted in more liberal eligibility provisions for disability benefits for this group. But going beyond this, organizations for the blind have continued to urge that the only eligibility provision should be 6 quarters of coverage (QC) earned at any time.[18]

Also, proposals have been made to shorten the waiting period—say, to three months (or less). If the waiting period were reduced to only one week, the program would be broadened to include temporary disability benefits on a nationwide basis (thus replacing the few state programs in this area).

Other changes have been proposed with regard to disability benefits. One is the elimination of the recency-of-employment requirement (20 QC out of the last 40 quarters), as is done for blind persons. Another is to pay full-rate benefits to disabled spouses and to widows and widowers regardless of age—rather than only reduced benefits for disabled widows and widowers aged 50 or over. Proposals have also been made to pay additional benefits with respect to disability beneficiaries who require constant attendance by another person.

Other proposals are intended to tighten up the disability determination and continuation procedures, including having such determinations made by the federal government, instead of the states. It is hoped that uniform administration, made by the agency that has to pay the benefits, would result in lower costs. In 1983–84, efforts were made by many persons to relax the strict, sometimes too rapid, enforcement of legislation enacted in 1980 that required more thorough reexamination of disability beneficiaries on the roll (see Chapter 10 as to the results arising therefrom).

Earnings of Married Women

Over the years, there have been criticisms of the unfair treatment of married women who work outside the home as compared with the treatment of those who work in the home. The latter receive a wife's benefit (or a widow's benefit), whereas the former receive only the *larger* of the benefit based on their own earnings record and that based on their husband's benefit. In many such cases, the wife may have a larger benefit from her husband's earnings record and thus appear to derive no advantage from her own earnings. This is, of course, not a matter of unequal treatment by sex, because the same

18. The author believes that this proposal is unreasonable, even taking into consideration the extremely great problems of the blind. This proposal would result in a lifetime immediate pension once 6 QC had been obtained even though the individual continued to have substantial earnings (as some blind do have). It would be unfair to blind persons who could not work enough to acquire 6 QC, easy as that is. Perhaps a better solution to the income problems of the blind would be to have a universal flat pension for them on a demogrant basis, financed from general revenues.

situation applies in reverse to the husband with respect to auxiliary benefits from the wife. The answers to the criticism are that the woman had certain protection in the past (for disability and survivor benefits and for old-age benefits if she retired before her husband did) and that social-adequacy principles throughout OASDI produce this result (as against individual-equity ones).

A somewhat related problem concerns married couples in which only one works in the paid labor market compared with those in which both do so, and the total family earnings are the same. Under these circumstances, where both members of the couple are the same age and the workers retire at age 65, the total family benefit is generally larger for the one-worker family than for the two-worker one. For example, for those attaining age 62 in 1990, a worker with an AIME of $1,000 had a PIA of $526.40, which yielded a spouse's benefit at age 65 of $263.20 and a total family benefit of $789.60 for retirement at age 65 (disregarding CPI increases for December 1990 and after). On the other hand, if both spouses had an AIME of $500, there would be two PIAs of $366.40 or a total of $732.80. Some persons view this as being inequitable, but the author does not, because these two families are by no means similar in all aspects of their economic structure and because individual-equity principles are not controlling in OASDI.[19]

Another change that has been actively proposed—and, in fact, was in the House version of the 1972 legislation, but was dropped in conference—is to give more recognition to the earnings of married women in computing benefits. One way of doing this (as contained in the House bill) is to combine the earnings record of the husband and wife and pay a benefit of 150 percent of the resulting primary benefit if this produces a larger amount than the sum of the two separate primary benefits.

Another approach is to pay the woman worker the larger of the benefit based on her husband's earnings record and the benefit based on her own record plus a fraction (say, one fourth or one half) of the smaller of those two benefits, instead of the present basis of paying only the larger of the two benefits. The Republican members of the House Ways and Means Committee made such a proposal as part of a package that they put forward in the consideration of the legislation that led to the 1977 Act. However, it was not accepted by the committee.

Another proposal is to pool the earnings of the married couple

19. It should be recognized that, in the past, the two-worker family very likely had greater benefit protections under OASDI than did the one-worker family—namely, for disability, survivor, and early-retirement benefits.

each year, even though only one might have earnings, and divide them equally between the husband and wife. In the event of the death of one spouse, the other would inherit the entire earnings record. Auxiliary and survivors benefits for aged spouses and widows would be eliminated.

Appendix 5-2 presents a more extensive discussion of these approaches and the problems involved therein, as well as several other approaches in the same area.

Equal Treatment of Men and Women

As a result of the 1983 Act, there is now prospectively completely equal treatment of men and women under OASDI (with one very minor exception). Appendix 3-2 described the few minor instances present in the law prior to the 1983 Act where such unequal treatment existed (and the one remaining very minor exception).

Other Benefit-Related Areas

In any program as complex as OASDI, there are a great many relatively minor areas where extensions of protection may be urged. Among these are such matters as providing benefits for other family members—brothers and sisters, disabled dependents (such as spouses, widowers, and widows) regardless of age, and so forth. Some of these proposals may be adopted in the future. However, from a cost standpoint, and in overall economic significance, they are not so important as the items previously discussed.

Another area where changes may be made is in connection with the termination of benefits when remarriage (or marriage) occurs. The present provision for not terminating benefits when remarriage occurs at or after age 60 might be extended to all ages, so that remarriage of a widow or widower or marriage of a child beneficiary will not result in the termination of benefit rights. At least in part, this would be in recognition of changes in lifestyles, so that, as a result, those who follow the traditional views of marriage are not penalized from an OASDI-benefits standpoint. The proposal of the Republican members of the House Ways and Means Committee in connection with the legislation leading to the 1977 Act contained this provision, and it was in the House-approved bill, but was dropped in conference.

Child school-attendance benefits were eliminated by legislation in 1981 (on a gradual phase-out basis), except at age 18 when attending high school (or lower), on the ground that such benefits overlapped with other available federal payments. However, some persons argue for their full reinstatement.

Financing

The possible developments in the benefit protection afforded by the OASDI system have been discussed without mention of the necessary financing. Each time that legislative activity has occurred in the past, Congress—particularly the controlling committees concerned—has carefully considered the costs of the proposed changes. The enacted provisions have been financed fully, according to the best actuarial cost estimates available, except that this was not completely done in connection with the 1977 Act, although it was done in the 1983 Act. Thus, Congress attempts to maintain the system on a self-supporting basis by keeping benefit costs very closely in balance, over the long range, with tax income.

Tax Rates

Height of Ultimate Tax Rate

Over the years, there has been much public discussion of how high the OASDI tax rates should ultimately go. Such discussion has arisen as the tax rates have increased and as some people have argued that they have reached the limit (or will soon do so) and that, accordingly, other forms of financing should be provided for OASDI. Secretary of Health, Education, and Welfare (later, Senator) Abraham A. Ribicoff stated in 1961 before the Senate Committee on Finance that the ultimate rate should never exceed 10 percent for the employer and employee combined, and the late Senator Harry F. Byrd heartily agreed with him. Since then, many other persons have supported this view. It may be noted, however, that in the Senate debate on the 1964 Act, Ribicoff (as a senator) voted for a hospital-benefits proposal that, combined with OASDI, had an ultimate rate of 10.4 percent, and he subsequently never referred to the 10-percent limit.

The scheduled ultimate OASDI rate (i.e., exclusive of the HI rate) for the employer and employee combined did not exceed 10 percent until the 1971 Act, when a rate of 10.3 percent was specified for 1976 and after, as compared with the previous 10.0 percent. Interestingly, scarcely any mention was made at that time about the first breach of the 10-percent limit. As a result of the 1973 Act, the combined employer-employee OASDI rate was scheduled to be slightly under 10 percent (9.9 percent actually) for the next 35 years, but the ultimate rate of 11.9 percent in 2011 and after far exceeded this "limit." Then, the 1977 Act broke the 10-percent barrier with a rate of 10.1 percent in 1978 (and an ultimate rate 12.4 percent in 1990 and after, which was continued in the 1983 Act).

On the other hand, the counterargument has been made that there was no magic about this arbitrarily selected 10-percent figure and that a higher rate would not be deleterious to the national economy. In this connection, it may be noted that the contribution rates for social security programs in many foreign countries (including such "free enterprise" ones as the Federal Republic of Germany) are well over 20 percent. In 1981, the National Commission on Social Security established a new "limit" by recommending that the maximum combined employer-employee rate of OASDI-HI should not exceed 18 percent (with general revenues then entering in for OASDI).

Size of Fund and Pay-As-You-Go Financing

Before 1984, the concern about the size of the OASDI Trust Fund was entirely that it was too small. However, the current intermediate-cost and low-cost estimates show very large fund balances developing in the 1990s and the two decades thereafter; even the high-cost estimate shows a large fund buildup until 2010. This situation results from the high-level tax rate after 1989 and from the favorable demographic situation in the 1990s and the next decade or so.

In the intermediate-cost estimate (alternative II in the 1991 Trustees Report), the ratio of the balance in the trust funds to the outgo in the next 12 months is 82 percent at the beginning of 1991 and rises to 229 percent for 2000. It then continues to rise and peaks at 418 percent in 2015. At that time, if the benefit structure is left unchanged, the combined employer-employee tax rate would have to be increased from the presently-scheduled 12.4 percent to about 16.4 percent. In the opinion of the author, any fund ratio of much more than 100 percent is unrealistic, and undesirable as well.

One solution is to provide for automatic adjustment of the tax rates after a certain fund ratio (such as 100 percent) has been achieved, so as to keep the ratio within a desired range. If the intermediate-cost estimate is fulfilled by the actual future experience, this procedure would result in somewhat lower tax rates in the 1990s and the next 15 years than are now scheduled, and somewhat higher rates thereafter.

Another solution would be to change the presently scheduled level tax rate of 12.4 percent for the employer and employee combined to an upward-graded schedule. Such schedule would have lower rates than the present rate in the early years and higher ones in the long run, until the ultimate years. At that time, the tax rate would have to be about the same as would be necessary under present law after the fund balance had been depleted (assuming no change in the benefit structure). This would be designed so that, according to the intermediate-cost actuarial estimate, a moderate fund balance (resulting in a fund ratio of, say, 100 percent) would be maintained at all times.

At the end of 1989, Senator Daniel Patrick Moynihan proposed that the schedule of tax rates should be revised so that the financing of the OASDI program would be returned to a pay-as-you-go (or current cost) basis. At the same time, this would eliminate the undesirable situation of the large annual excesses of income over outgo of the OASDI Trust Funds being used in the Gramm-Rudman-Hollings budget-deficit-reduction target computations to hide the disastrously large general-budget deficits. As pointed out earlier, Senator Moynihan termed this situation "fraud"; the late Senator John Heinz called it "embezzlement"!

The basic difficulty involved in the current large excesses of income over outgo of the OASDI Trust Funds (often erroneously referred to as "surpluses") is that this procedure hides the full—and horrendous—extent of the budget deficit in the general operations of the federal government.

The budgeting practices are also deceptive and non-revealing in two other ways. First, the figures shown as to interest on the National Debt do *not* include—as they should—the interest payments to the OASDI Trust Funds (and other smaller ones as well) on the government obligations which they hold; such bonds are valid investments and are part of the National Debt, and accordingly such interest is real and meaningful. Second, OASDI-HI payroll taxes which are paid by the federal government as an employer do *not* count as general spending in the budget; such taxes for the federal government—just as for private employers—are a genuine cost of "doing business."

The tax schedule (for employer and employee combined) that Senator Moynihan originally proposed was as follows:

Period	*Rate*	*Period*	*Rate*
1990	12.12%	2020–24	14.00%
1991–2011	10.20	2025–44	15.40
2012–14	11.20	2045 and after	16.20
2015–19	12.40		

This proposal resulted in widespread discussion and debate. Those who opposed it often did so for disparate reasons. Often, the stated reasons were not the real underlying ones. The budgeteers were really concerned with the heightened budget problems that would result (or, rather, would become more apparent). Some economists who were primarily interested in increasing the national savings rate (which they believed would result from large trust-fund accumulations) opposed the proposal. Those with the expansionist philosophy also opposed it—on the grounds that safety and prudence dictated the buildup of large fund balances—because of their belief that irresistible political pressures would develop to liberalize benefits in the near future "because all that money was there in the trust funds."

Others too were concerned about having an adequate contingency reserve for the OASDI program. By frequent repetition, a myth was created that a minimum fund ratio of 150 percent was essential. This claim had no actuarial or statistical foundation whatsoever: actually, evidence exists that a fund ratio of 100 percent is adequate to carry the fund safely through an unfavorable economic cycle. If a fund ratio of this magnitude had been present in 1977 (instead of the actual one of 47 percent), the financing crisis that occurred in 1981–83 would not have arisen—see Robert J. Myers, "Social Security under the Moynihan Proposal Is Responsibly Financed," *Update*, National Academy of Social Insurance, Washington, D.C., May 1990.

Furthermore, under responsible pay-as-you-go financing, it is anticipated that if unfavorable experience developed, the tax rates will be adjusted upward (and vice versa). Also, only relatively small changes are likely to be necessary.

In view of these criticisms, Senator Moynihan modified his proposal so as to phase it in gradually. The result was that the effect on the short-range budget-deficit computations was lessened and that the fund ratio of the OASDI Trust Funds would rise to about 140 percent in 1997 and would remain at about this level for the next 25 years and then be at a level of about 120 percent for the remainder of the 75-year valuation period. The tax schedule for the combined employer-employee OASDI tax rate under the revised proposal was as follows:

Period	*Rate*	*Period*	*Rate*
1990	12.4%	2010–14	11.6%
1991	12.0	2015–19	12.4
1992	11.6	2020–24	13.6
1993	11.2	2025–29	15.0
1994	10.8	2030–44	15.8
1995–2009	10.4	2045 and after	16.2

Then Senator Moynihan modified the proposal further so that the effect on the budget-deficit calculations was even further lessened. The previously-proposed tax rates were increased slightly in the first few years, and (more importantly) maximum taxable earnings bases would be established in the law for 1991–96, rather than having them be determined under the automatic-adjustment provisions. Such established bases would be higher than those that would be expected to arise under the automatic-adjustment procedure, so that more revenues would flow into the trust funds (and thus "help" the budget-deficit situation). The OASDI tax rates under this revised proposal were as follows (for employer and employee combined):

Period	*Rate*	*Period*	*Rate*
1991	12.12%	2010–14	11.2%
1992	11.8	2015–19	12.4
1993	11.4	2020–24	13.6
1994	11.0	2025–29	14.8
1995	10.6	2030–54	15.6
1996–2009	10.2	2055 and after	16.2

At the same time, the maximum taxable earnings bases established by law were as follows (and also these estimated under the automatic-adjustment provisions of present law):

Year	*Present Law (estimated)*	*Proposal*
1991	$54,300	$55,500
1992	57,300	60,000
1993	60,300	65,400
1994	63,600	71,400
1995	66,900	78,000
1996	70,500	85,500

After 1996, under the proposal, the bases would again be automatically adjusted.

The ad hoc increases in the earnings bases were designed so that, taking into account the reduced tax rates, everybody would have some reduction in the total tax paid, but those with the highest earnings would have only relatively small decreases (whereas, under the earlier versions, such persons would have proportionately the same reductions, and thus larger ones in dollar terms). For example, a person with $85,500 or more earnings in 1996 would pay an employee

OASDI tax of $4,371 under present law as compared with $4,360.50 under the proposal.

This proposal was considered on the Senate floor in October 1990 and received a favorable vote of 54 to 44. However, this was not sufficient for passage, because 60 votes were needed to waive the procedural rules (since "violation of budget-busting restrictions" was involved).

Then, in early 1991, Senator Moynihan introduced a further revision of his proposal, which was essentially merely fine-tuning of the preceding version. The OASDI tax rates for the employer and employee combined were as follows:

Period	*Rate*	*Period*	*Rate*
1991 (to June 30)	12.4%	2015–19	12.4%
1991 (after June 30)	11.4	2020–24	13.6
1992–93	11.4	2025–29	15.0
1994–95	11.0	2030–39	15.6
1996–2009	10.4	2040–49	15.8
2010–14	11.2	2050 and after	16.2

At the same time, the maximum taxable earnings bases established by law were as follows (and also revised estimates for present law, under the automatic-adjustment provisions):

Year	*Present Law (estimated)*	*Proposal*
1992	$55,800	$60,600
1993	59,100	64,200
1994	62,400	70,200
1995	65,700	73,800
1996	69,300	82,200

Under this revision, just as under the one developed in late 1990, the fund ratio would rise to about 140 percent in the late 1990s and then continue to increase until peaking at about 165 percent in 2010. Then, a slow decline would occur, until a leveling-off at about 130–140 percent would be present in 2025–65.

Some increase in the support for the general principles of the Moynihan proposal was evident in early 1991, because of the belief that this would be a good stimulant to the economy, which was in a recession mode. However, in April a procedural vote was taken on the general approach to permitting the Moynihan proposal to be considered within the budget restrictions, and it lost by a vote of 60 to 38.

Further support for funding OASDI on a pay-as-you-go basis was given by the Committee on Social Insurance of the American Academy of Actuaries. In a report of February 1990, the committee unanimously concluded:

> The OASDI Trust Funds should be removed from the GRH targets, and the long-term contribution schedule should be increased so that the trust funds are financially sound in all future years. If these two goals are achieved, then either current-cost or partial-reserve financing is actuarially sound.
>
> Although either the current financing system or a current-cost system is acceptable, a majority of the Committee agreed that the current-cost method is preferable.

Employer Tax Rate

Because of the argument of some economists that the employer payroll tax for OASDI is directly passed on to employees in the form of lower wages than would otherwise have been paid, some persons have suggested that it should be eliminated. Instead, the corporation income tax would be used to help finance OASDI. Quite obviously, other taxes would then have to be increased to fill in the gap in general revenues thereby created. This proposal seems to be just another strategy to make less obvious to the general public what the true cost impact of the OASDI program really is. On the other hand, some suggest that the employer rate should be higher than the employee rate, as is the case in many countries.

Self-Employed Tax Rate

The matter of the tax rate for self-employed persons relative to that for employees has been considered from time to time—especially as both the rate and the earnings base have been risen. The tax burden on the self-employed is particularly evident because their tax is customarily paid in a lump sum quarterly, when income-tax payments are made—rather than by the "painless" method of withholding from pay, as is done for employees. The self-employed OASDI rate was lowered from its original basis of 1½ times the employee rate by the 1965 Act, but this relationship was essentially restored by the 1977 Act, effective in 1981. Now that the 1983 Act has set the self-employed tax rate at the combined employer-employee rate (but with an allowance for the effect of the employer portion of the tax on income taxes), it would appear that no further change in the general principle is likely. The detailed procedure might, however, be altered (e.g., as between that used in 1984–89 and that used subsequently).

Proposed Immediate Increases in Tax Rates

Martin Feldstein, when a professor of economics at Harvard University, advocated an unusual position as to OASDI financing in his paper "The Optimal Financing of Social Security," published in 1974 by the Harvard Institute of Economic Research (Discussion Paper No. 388). It takes an opposite position from current-cost financing. In fact, what he advocates goes far beyond full-reserve financing.

Feldstein proposed that an extremely large fund should be built up within a decade by more than doubling the OASDI tax rates. Then, this fund would be large enough so that no payroll taxes would be necessary in the future, because the interest income would be sufficient to meet the outgo of the system. Such a result would be accomplished by having the fund's investments earn the "social rate of return," which would be about 13 percent, representing the actual average rate of investment earnings of business corporations *before* income tax applies. Obviously, the excess of such rate over what the government normally pays on its debt obligations would be a hidden subsidy to the system.

The author believes that the Feldstein proposal, which certainly can be classified as unique and innovative, is completely impractical and undesirable, as well as having no popular appeal. It would seem impossible to convince current workers to pay such high tax rates so that future generations of workers would have none to pay. Also, there is serious question as to whether the prescribed size of the fund (a mere $600 billion in 1974 dollars, which would be about $1,680 billion in 1992 dollars) would be sufficient as an interest-earning endowment fund to finance the program over the long range, even at the artificially high interest rate of 13 percent. Significantly higher tax rates than Feldstein's proposal of double the present ones, if they are to be levied for no more than a decade, would probably be necessary to build up such an endowment fund.

The basic idea behind the proposal seemed to be to strengthen the capital structure of the nation. If this were to be done, it would seem far better to do so outside the OASDI system, which should have as neutral an effect on the economy as possible and should not be used as a general economic tool.

In considering the sizable increase in OASDI costs, and thus tax rates if the program is financed on a pay-as-you-go basis, beginning in about 2010, an at least partially counterbalancing factor is present.

Demographic trends, especially if zero-population-growth tendencies continue to prevail, indicate a much higher proportion of aged in the population then, and this is the basic reason for the higher OASDI costs. However, offsetting this is the fact that the proportion of children will be correspondingly lower. It may be said in broad terms that the higher cost of providing for the nonproductive aged will tend to be at least partially counterbalanced by the lower cost of supporting dependent children. It is, of course, true that there are no exact offsets for each individual, although certainly the lower school taxes (if they materialize, as they logically should) will be spread among all persons.

Taxable Earnings Base

Closely related to the maximum desirable tax rate for the OASDI system is the size of the maximum taxable earnings base. Proposals have been made to eliminate the maximum taxable earnings base only as it is applicable to the employer tax (as, for example, by the Carter administration in connection with the legislation leading to the 1977 Act). This would, of course, provide considerable additional financing, because no additional benefit liabilities would be created, as is the case when the base is raised for the worker taxes. The effect of such a change for the employer tax if it were made under present law would be to provide additional financing of only about 5 percent relatively.

It is interesting that the net long-range financial gain to the OASDI system of increasing the earnings base for *both* workers and employers is about the same as if this were done only for employers. In other words, the long-range cost of the additional benefits resulting is about the same as the long-range value of the worker taxes. This again indicates that increasing the base is as much a benefit-level policy matter as a financing matter. Of course, for the HI system with its uniform benefits, raising the taxable earnings base, whether for employers only or for both employers and workers, results in a full gain from a financing standpoint.

Government Subsidy

It seems probable that the careful cost consideration of OASDI by Congress will continue in the future. Accordingly, the most significant development likely in connection with the financing is the extent to which the program should remain self-supporting from the payroll taxes of workers and employers, or whether, as is common in some countries and as some persons urge here, a specific government subsidy (or, as some refer to it, a government contribution) should be introduced.

As noted previously, the 1983 Act introduced a permanent government subsidy to the OASDI program through levying income taxes on the benefits of high-income persons and returning the proceeds to the trust funds—and also doing so earlier than was equitable, as described in Chapter 2 (as well as a temporary subsidy for 1984, with regard to not increasing the employee tax rate, but making up the difference from the General Fund). The question remains as to whether more general-revenue financing, perhaps in a more direct manner, will be legislated.

Subsidy from General Revenues

The Committee on Economic Security, which made the studies underlying the initial Social Security Act, recommended a government subsidy for its proposed contributory old-age benefits plan. Such subsidy would not have been initiated until 1965, about three decades after the inception of the program, but would eventually have met about one third of the annual outgo. President Roosevelt, however, rejected this approach and instead favored the self-supporting basis, and Congress concurred. He did this perhaps in view of the public criticisms of his unbalanced budgets (not very large, even relatively, in light of the current situation!) and his desire not to be criticized for proposing legislation with built-in large federal subsidies for long-distant future years.

In the following years, many persons continued to advocate the introduction of a government subsidy into OASDI. This was recommended by the Advisory Council on Social Security in 1938 and, again, by the 1949 one. However, Congress did not follow such recommendations. Subsequent advisory councils did not make such proposals, although the 1971, 1975, and 1979 advisory councils recommended that either part or all of the cost of HI should be financed from general revenues and that some of the HI tax rate should be transferred to OASDI (for more details, see Chapter 7).

Generally, those who believe in the expansionist philosophy support the idea of injecting a government subsidy into the financing of OASDI. It seems likely that their underlying reason is that thereby higher benefit levels can be more easily achieved, because the unpopular action of increasing visible payroll taxes can be avoided. Curiously, some fiscal conservatives support general-revenue financing of Social Security, but at the same time they couple this position with changing OASDI from a social insurance program to a public assistance one.[20]

Supporters of government subsidies to OASDI and HI often disregard the fact that the government is not an independent, self-sufficient entity. For example, in a minority statement in the report of the 1975 Advisory Council on Social Security, a member associated with the National Council of Senior Citizens argued in favor of a government subsidy to the Social Security system in the following manner: "Thus, in the long run, I see a social security system covering both cash benefits and health insurance financed partly by employer contributions, partly by employee contributions, and partly by contributions from the government in recognition of society's stake in a well-functioning social insurance program." In reading that statement, one would think that "the government" or "society" was something completely separate, with its own financial resources, from the employers and workers and their dependents, who constitute almost the entirety of the nation's population.

Advocates of a government subsidy to the OASDI system had their position somewhat strengthened by the change in the Railroad Retirement system in October 1974 that provided a significant amount of its financing through monies from the General Fund of the Treasury to pay for the cost of certain windfall dual benefits (see Chapter 12). Others would argue that this was not necessarily a precedent, because the subsidy of a small group by the whole body of taxpayers is different from the latter attempting to subsidize themselves.

As discussed in Chapter 3, considerable pressure for a government subsidy to OASDI developed in 1977–78. In 1977, the Carter administration proposed this, and although it received some support in Congress, it was decisively rejected. Then, in early 1978, due to the public reaction to the future higher taxes legislated, there was a strong movement to roll back the tax increases and to replace the lost revenues by government subsidies. The Carter administration reversed itself and opposed this at that time. Congressional leaders, too, were in opposition, and no action was taken.

The aforementioned introduction of a limited, hidden, and partially temporary government subsidy in the 1983 Act came about as a result of the severe financing crisis and the necessity for a bi-partisan consensus solution whereunder all parties involved "swallowed" some of their principles. The same sort of subsidy was provided for the Railroad Retirement system (not only for the income-taxation of its

20. For example, see Milton Friedman, *Social Security: Universal or Selective?* (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1972).

tier-1 benefits that are actually primarily OASDI benefits, but also for the income-taxation during 1984 through September 1992 of the remainder of the tier-1 benefits and all the tier-2 benefits).

Use of Value-Added Tax

In the late 1970s, Representative Al Ullman, chairman of the House Ways and Means Committee, suggested that consideration be given to the possibility of partially financing OASDI and HI from a value-added (or wholesale transaction) tax. At the same time, he strongly opposed any subsidy from general revenues. In late 1978, Senator Russell B. Long, chairman of the Finance Committee, also proposed this. The advantages claimed for the value-added tax as compared with the payroll tax are that, being based on consumption, it would not so adversely affect capital savings, productivity, and employment, and it would be a more stable source of revenue. Others, however, strongly oppose the value-added tax on the grounds that it is really just a sales tax in disguise and is thus a regressive tax.

There is no doubt that the issue of further government subsidy to OASDI is not a closed matter and much will be heard about it in the future. An extensive discussion of the issues involved is contained in the next section.

Taxation of Benefits

OASDI benefits (and Medicare ones, too) were not subject to federal income tax prior to the 1983 Act (and, accordingly, states followed the same practice for their income taxes). This was not the result of legislation, but rather of rulings of the Bureau of Internal Revenue (now the Internal Revenue Service) in 1938 and 1941. The basis of these rulings was apparently that the amounts involved were small and could be considered as gifts or gratuities from the federal government.

It would seem that, from the standpoint of logic, OASDI benefits should be taxed on the same basis as any other pension or annuity—namely, by considering the payments in relation to the individual's own contributions made toward them in the past. The aggregate contributions are presumed to purchase an annuity whose amount is calculated actuarially (on a no-interest or life-expectancy basis), and the excess of the actual payment over such amount is then taxable.

Because OASDI benefits had been made nontaxable—and for so many years, too—it seemed very difficult to make a change. The beneficiaries pointed out that their present income was already low and should not be decreased. Then, too, there was great misunderstanding of the matter, because many believed that, in all cases, income tax would be due, whereas this was not so because of personal exemptions and deductions.

For example, if the proposal of the 1979 Advisory Council of making half the benefits subject to income tax had been in effect for 1979, a single person aged 65 or over would not have had any part of the OASDI benefits taxable if total income (including 50 percent of the OASDI benefits) was less than $4,300. The corresponding figure for a married couple both aged 65 or over was $7,400. Because 50 percent of the maximum benefits payable in 1979 (e.g., $6,340 for a person who attained age 65 in early 1979 and $9,510 for a similar married couple) was so far below these amounts, no person whose income was predominantly from such benefits would pay income tax on benefits under this proposal. It may be noted that, in 1976, the proportion of OASDI beneficiaries receiving 80 percent or more of their income from OASDI benefits was 23 percent for married couples with the husband aged 65 or over and 33 percent for nonmarried persons aged 65 or over (*Social Security Bulletin*, July 1979, p. 29).

One possible method of taxing OASDI benefits would be to consider them in the same way as any other pension benefit. This would be difficult, however, because few individuals would know the amount of the OASDI taxes that they had paid (and accurate information as to this is not readily available from the Social Security Administration). Also, beneficiaries would have strong objections, because very high proportions of the benefit payments (about 85 percent or more generally, at present) would be considered taxable income.

Another method is that proposed by the 1979 Advisory Council, mentioned previously. The logic underlying it (which is somewhat questionable) is that half of the benefit is "bought" by the employee tax, on which the individual had already paid income tax. Obviously, this is true only on a broad, long-term averaging basis for employees (and not at all for the self-employed).

Still another approach would be to apply to income other than OASDI benefits the higher income tax rates which would have applied if the OASDI benefits had been taxable and such other income had been considered on top thereof. This procedure would not really be taxing OASDI benefits (those with no other income than OASDI would never pay any income tax), but rather it would make more logical tax rates applicable to other income of the beneficiary.

Rather surprisingly, considering how frequently many members of Congress had stated that Social Security benefits would never be subject to income tax, the 1983 Act provided for as much as 50 percent of OASDI benefits being included as taxable for income-tax purposes for high-income persons. Over the years, because the thresholds which determine who are "high-income" persons are not indexed, higher proportions of beneficiaries will fall into this category, until eventually all will (although they will not all have income-tax liabilities). Thus, the 1983 Act, in essence, adopted the proposal of the 1979 Advisory Council, but with a very long phase-in period. It is not impossible that Congress will, at some later date, not let this occur—by raising the thresholds (but then other financing, or benefit reductions, will be necessary).

Since 1983, proposals have frequently been made to increase the proportion of OASDI benefits which is subject to income taxes—for example, to 85 percent. For a justification of the 85-percent figure, see Robert J. Myers, "The Proper Basis for Taxing Social Security Benefits," *The Actuary*, Society of Actuaries, October 1989. These proposals were put forward for budget-balancing reasons, not OASDI ones. In order to have a real effect for this purpose, the additional income-tax receipts would have to remain in the General Fund of the Treasury. This should be done rather than transferring them to the OASDI Trust Funds, as is the case for the receipts from the "50-percent" basis in present law (which only reduces budget-deficit-reduction targets under the Gramm-Rudman-Hollings law, not real deficits or the national debt).

Issues

Social insurance is a subject that has never suffered from a lack of debatable issues, especially when individuals embracing different philosophies come together. Seven issues are included here as representative of current debate. These include the question of who pays the tax, whether or not the tax is regressive, whether OASDI should be further partially financed from general revenues, whether or not OASDI is a good buy for a young person, whether OASDI increases or decreases private savings, the relative burden of OASDI-HI taxes as compared with personal income taxes, and whether minority groups and low-paid workers are equitably treated.

Who Pays the Social Insurance Taxes?

In examining the difficult, even nebulous, matter of who pays the payroll taxes that finance a social insurance system, there are several factors to be considered. Of course, the average person might well say that this is an obvious matter—for example, under OASDI the employer pays half the cost and the employee pays the remainder. But, in the economic world, life is not that simple! Let us consider here the views of economists on who really pays the employer and employee taxes, whether the taxes are individually assignable, and an interesting example in the Railroad Retirement system on the difficulty of determining the tax incidence.

Views of Economists on Employer and Employee Taxes

Over the years, economists have considered the very intriguing topic of who really pays social insurance taxes. Great intellectual exercise can be obtained from speculating on the real incidence of the Social Security taxes. All sorts of answers can be derived in theory. Moreover, the use of statistics (possibly also with elegant simulation exercises on electronic data-processing machines) can make the matter even more challenging and add the appearance of scientific precision.

Is the employer tax passed along to the consumer in the form of higher prices? Or is it really paid by employees through lower wages than would be received otherwise? Or does it result in lower profits? Or is it paid partially by the federal government (and thus by the general taxpayer, who is largely in the employee category), because employer Social Security taxes are counted as a business expense and thus result in lower employer income taxes?

Then, in regard to the employee tax, does the worker really pay it himself or herself? Or does the employer pay it as a result of wage demands being higher on account of such tax deductions? After all, many employees are consciously or unconsciously aware of economics. What they really consider is not their gross pay but rather their take-home pay.

Many economists are currently of the view that the employee taxes are really part of the total compensation of employees. Therefore, they conclude that the employer Social Security taxes are paid by the employees. There is a question, on grounds of general reasoning, whether this can actually be proved. In the field of mathematics, it is not possible to find a solution for every problem posed. In fact, it can be shown in some cases that precise solutions are impossible—for example, squaring the circle. The same situation also prevails in the field of economics.

In this respect, a Technical Analysis Paper of the Congressional

Budget Office ("Aggregate Economic Effects of Changes in Social Security Taxes," August 1978) concluded that three fourths of any increase in payroll taxes is passed through to consumers in the form of higher prices and that only one fourth is likely to diminish direct wage payments. It is also believed that such action may not occur *in the very short run* because of the inflexible nature of prices and wage rates, and so profits may absorb the effect of the change in employer tax rates.

The incidence of taxation—although a fascinating subject and problem—is not, in this real world, amenable to precise solution, because the initiation of a tax often, if not generally, changes the situation completely. For example, with the high personal income tax rates on upper incomes, salary increases for executives are made relatively large to produce a given net result after taxes. Similarly, when self-employed professional people establish their fees, they consider, not the gross amount to be asked, but rather the net result desired.

Are Social Insurance Taxes Individually Assignable?

For the moment, let us accept the conclusion of many economists that Social Security taxes are, in the long run, borne by employees in the aggregate. However, one cannot then logically or reasonably jump from that conclusion to the conclusion that each employee is himself or herself really paying the employer tax levied on his or her earnings. Some economists take that jump in the dark, because they do not give adequate consideration to the mechanics of fringe benefits generally—both social insurance and private-sector benefits.

In private employee-benefit plans, the employer cost is usually expressed as an average percentage of payroll, but this does not by any means indicate that the employer is paying the same relative amount for each employee. In actual practice, the employer usually pays much more proportionately for older employees, especially under pension plans and group life insurance plans, although the reverse can occasionally be the case (e.g., maternity benefits). Similarly, the employer cost, although stated as an average for all employees, may differ widely among various departments or branches of the business. Yet it is not customary to allocate such fringe-benefit costs on an experience basis among the segments of the firm.

In the same way, under a social insurance program, it is assumed that in the aggregate for the country as a whole, the employer taxes are really part of the remuneration of the employees and are therefore borne by them. Then, there is no reason to assert that the employer tax is allocated to each employee directly and individually.

Instead, it seems more reasonable and logical to consider that the high-cost employee (the older one, or the low-paid one, or the one with dependents) receives a much higher amount from the employer tax than the amount of his or her own tax. Because the system is a nationwide one with universal pooling, such allocation can occur beyond the walls of the particular employer. Thus, the employees of one firm might really be said to have allocable employer contributions from the other firms. Or, conversely, the employees of a particular employer might, on this risk-allocation basis, have less assigned to them in the aggregate than the amount of the taxes paid by their employer.

Incidence of Railroad Retirement Taxes

A vivid example of the difficulty in determining who is really paying the social insurance taxes is in connection with the Railroad Retirement system (which is dealt with in Chapter 12). From its inception in 1937, the payroll tax was, according to the provisions of the law, shared equally by the employer and employee. In 1973, the scheduled total rate (including the tax rate for the HI portion of Medicare) was 21.2 percent, or 10.6 percent for each party. Beginning in October 1973, as a result of collective bargaining between management and labor, the employee rate was reduced to the same amount as under OASDI-HI (5.85 percent) and the employer rate was correspondingly increased (to 15.35 percent).

At first glance, this would seem to indicate that some of the employee cost of the RR system (namely, 4.75 percent of payroll) was shifted to the employer. But really it was not done by this action, because at the same time the railroad labor unions agreed to take only a 4-percent wage increase for an 18-month period, whereas most wage increases given in the recent past in other large industries had averaged about 9 percent for such a period (i.e., at an annual rate of 6 percent). Thus, the employer cost for wages and RR tax was about the same after this change as if the RR tax basis had remained essentially unchanged and a 9-percent wage increase had been given. At the same time, the net take-home pay of the employees (gross pay minus RR tax) also was about the same, although they did obtain a financial advantage insofar as income tax was concerned. Also, because the gross wages were lower than if a 9-percent wage increase had been given, the RR taxes and the future RR benefits would be lower, except for those with earnings well above the maximum taxable earnings base.

Conclusions as to Tax Incidence

The foregoing discussion referred only to the incidence of the employer tax and how it should logically be allocated to employees on a risk basis, rather than directly and individually proportionately. It may be reasonable to assume that the employee tax is paid entirely by each employee individually, although even this assumption is not necessarily and absolutely so. In fact, legally it has no foundation; the tax is a liability of the employer, who is permitted to deduct it from the employee's wages, although the employer may pay both shares; under these circumstances, the law provides that such payment of the employee tax by the employer constitutes additional wages for OASDI-HI purposes, and it is also counted as income for income-tax purposes.[21]

Similarly, the self-employed can logically be considered to be a combination of worker and employer. Any excess they pay over what the employee tax would have been on their earnings can be presumed to be employer taxes, which are pooled for the benefit of the system as a whole.

Are Social Insurance Taxes Regressive?

Alleged Regressivity of Social Insurance Taxes

Critics of the payroll taxes that are used to finance social insurance programs involving employee contributions and a maximum taxable earnings base are quick to point out that they are regressive (and therefore presumably undesirable, so that this financing basis should be changed).[22] Their argument points out, correctly, that the tax rate is a constant percentage up to the maximum taxable earnings base. Thus, the same tax rate is paid by all persons earning less than the base, whereas those earning more than the base pay an *average* rate that is lower. For example, the average tax rate for a person earning five times the maximum base is only one fifth of that for a person earning the base amount or less. Obviously, say the critics, this is a clear, deplorable instance of regressive taxes.

21. In practice, most employers of domestic workers use this procedure and are exempted from counting the employee tax as additional wages. Before 1981, the latter procedure was permitted for all employers (see Appendix 2-13).

22. See John A. Brittain, *The Payroll Tax for Social Security* (Washington, D.C.: Brookings Institution, 1972).

But when both sides of the coin are considered—benefits and taxes—OASDI and HI are definitely *not* regressive. Looking merely at the tax side is playing ostrich. OASDI benefits are heavily weighted in favor of low-paid workers, as discussed in Chapter 2. As far as HI is concerned, the benefits are uniform, regardless of the earnings level. Moreover, no significance can be attached to the fact that the average tax rate for those earning more than the base is lower than that for those at or below it, because no additional benefit rights are created on earnings above the base.

At times, this argument about the weighting of OASDI benefits in favor of the lower-paid workers is countered by two other points. First, it is asserted that the lower-paid begin employment earlier and have higher mortality (not especially because of the occupational risks, but rather because mortality continues to be inversely correlated with economic level). As a result, their retirement benefits, although weighted in their favor, have less value. Although these elements are present, acting in the other direction are the higher retirement rates and the presence of disability and survivor benefits (which are, with higher disability and increased mortality, of greater value). Second, it is argued that the lower-paid have more immediate needs for their small income than social insurance contributions, even though they may "purchase actuarial bargains." Such an argument, in the author's view, is not relevant, because all persons should desirably do something for their own future economic security and thereby reduce slightly their expenditures for current items.

The critics of the payroll tax also argue that, for many people, the OASDI-HI taxes are larger than the personal income tax. This seems to be irrelevant because the two taxes are not really comparable. A similar statement could be made, especially for low-income persons who pay little or no income tax, if the illogical comparison of automobile expenses and income taxes were made. The whole intent of the progressive income tax is to have the low-income group pay little or no income tax, but there is no compelling reason that this should be so for OASDI and HI (as discussed later). Also, if it is advocated that OASDI-HI taxes be put on a "progressive" basis, why is this not advocated for other taxes that are on a direct-use basis, such as automobile taxes, tolls, and even all real estate and sales taxes (by basing them on the buyer's income, rather than on the value of the item taxed)?

OASDI and HI benefits can properly be considered just another type of service or commodity that individuals are purchasing. The fact that the law compels them to make this purchase seems no more important than that they are compelled by a law of nature to consume food (which they must purchase). It seems democratic that the prices of goods and services should be the same for everybody, so that people are not subject to the stigma of being second-class citizens to whom government-required lower prices are applicable.

When President Franklin D. Roosevelt was confronted with the criticism that the payroll tax was regressive, he rebutted "I guess you're right on the economics, but those taxes were never a problem of economics. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions. With those taxes in there, no damn politician can ever scrap my social security program" (as quoted in Arthur Schlesinger, Jr., *The Coming of the New Deal* [Boston: Houghton Mifflin, 1959]).

Proposals to Reduce Regressivity

Those who argue that the OASDI-HI payroll taxes are regressive offer several solutions. One is to increase the maximum taxable earnings base to a much higher level. In this way, the alleged regressivity would be reduced, although not eliminated. Such an approach seems undesirable, because it would unnecessarily expand the scope of OASDI benefits for the highest paid and thus diminish private-sector activities in the economic-security field.

Another approach suggested by the critics of the payroll tax is to give special exemptions to lower-income workers so that all or part of the payroll taxes they paid will subsequently be refunded to them through the income tax return. For example, the taxes on the first $600 might be refunded for everybody, so that the *average* net tax rate paid would have an increasing trend as wages increase. Or a basis can be developed so that the reduction applies only for the lowest-income group and then gradually phases out as earnings increase.

But looking at the situation from the standpoint that OASDI-HI is a type of financial service that individuals purchase, why should a low-wage person not maintain his or her dignity and feeling of personal pride and self-reliance by paying the same for it (as a percentage of their income) as does the next person?

The crux of the problem seems to be that those who favor so-called tax relief from the payroll tax for the poor do not recognize that the problem is on the income side. Accordingly, it would seem more logical that an attempt should be made to solve the problem directly and forthrightly—not merely by considering and acting upon only one of the expenditure items.

Earned-Income Tax Credits

In early 1975, when efforts were made to combat the decline in the economy by providing massive tax reductions, one proposal was to reduce OASDI-HI taxes for low-income workers. The bill which passed the House provided that, for 1975 only, there would be a tax refund of 5 percent of the excess of (1) earned income up to $4,000 over (2) twice the excess of the individual's adjusted gross income (or, if larger, the earned income) over $4,000. The effect of this would be to result in no refund for earned income of $6,000 (or over).

The House committee report was somewhat equivocal on the purpose of this proposal and its relation to the OASDI-HI program. It stated:

> It is appropriate to use the income tax system to offset the impact of the social security taxes on low-income persons in 1975 by adopting for this one year only a refundable income tax credit against earned income. Although the earned income credit may be viewed as a method to help compensate wage earners of low-income families for much of the social security taxes they pay, your committee wished to have it clearly understood that this provision of the bill is not intended to provide a way of reducing social security taxes paid by low-income wage earners (House Report 94-19, February 25, 1975).

What this seems to say is that the OASDI-HI program receives the full taxes from low-paid workers, but they are reimbursed therefor from the General Fund of the Treasury (i.e., from general revenues).

The final legislation related only to families with children, but the tax credit or refund rate was 10 percent, phased out at incomes of $8,000. As with many other "temporary" measures in the social-welfare area, this provision was later made permanent, rather than applying for only one year. And it has since been liberalized.

It may properly be said that these earned-income tax credits have developed into an income-related children's allowance program, although they started out as offsets against OASDI-HI taxes. Or it might be said that the program results in a government subsidy to OASDI-HI, though a rather indirect one.

In 1990, the tax credit was 14% of earned income up to $6,810 (maximum credit of $953) if the Adjusted Gross Income is less than $10,730. For higher AGI, the maximum credit is reduced by 10 percent of the larger of (a) earned income in excess of $10,730 or (b) AGI in excess of $10,730, so that the credit phases out for earned income or AGI of $20,264 or more. In future years, the several dollar figures involved are indexed, in accordance with changes in the average CPI for All Urban Consumers for 12-month periods ending with August.

The Omnibus Budget Reconciliation Act of 1990 liberalized the earned-income-credit provisions for 1991 and after in several complicated ways. First, the tax-credit percentage varies by number of children and is increased, being 16.7 percent for cases of one child and 17.3 percent for cases of two or more children in 1991, phasing up to 23.0 percent and 25.0 percent, respectively, in 1994 and after. Second, and partially offsetting, the phase-out percentage is increased from 10 percent to 11.93 percent for cases of one child and 12.36 percent for cases of two or more children in 1991, phasing up to 16.43 percent and 17.86 percent, respectively, in 1994 and after. Third, if a child under age 1 is present at the end of the taxable year, an additional tax credit of 5.0 percent is given, with an increased phase-out percentage of 3.57 percent. Fourth, if the family had health insurance for which it pays the premium (or part thereof), an additional tax credit of 6.0 percent is given, with an increased phase-out percentage of 4.285 percent (but the credit cannot exceed the premium paid).

Should OASDI Be Partially Financed from General Revenues?

Some persons claim that the OASDI-HI payroll tax, considering only the employee tax, is regressive and that therefore relief should be provided by having partial financing from general revenues, or what is euphemistically referred to as a *government contribution*, but might better be termed a *government subsidy*.

Others go further and believe that the situation is doubly bad because of their view that the employee in reality pays the employer tax. The latter group suggests eliminating the payroll tax and substituting general-revenue financing, preferably obtained by raising income-tax rates. They assert that what they consider to be the myth of the "insurance" concept in the OASDI program is what is really thwarting their efforts and that, if they can only destroy it, all will be well. Actually, as discussed in Chapter 1, the insurance concept is not a myth and is, in fact, one of the underlying strengths of the program. To destroy this concept would very likely result in the destruction of OASDI and a changeover to a public assistance program, with all the inherent weaknesses of such an approach.

Expansionist Reason

Some persons who favor significant expansion of OASDI to have much higher benefit levels strongly oppose the views of those who question its insurance principle and seek to weaken greatly the payroll-tax financing basis. Nonetheless, such expansionists favor the infusion of some government subsidy into the program, hoping that a little such subsidy (proportionately) will not weaken the insurance principle. Their reason for such a compromise is that the general level of the payroll tax is now so high that covered workers are complaining about this. Thus, any further benefit increases beyond those necessary to keep the benefits up to date with the cost of living will be difficult to accomplish if there is solely payroll-tax financing.

This is the principal reason why no further government subsidy should be introduced into OASDI on a permanent ongoing basis. If the system is financed to as great an extent as possible on a completely self-supporting basis in the future, the covered workers and their employers will be fully cognizant of the costs involved, as a result of the observable direct impact of the payroll taxes. They can then decide, on an informed basis, just how much further expansion of the government program they desire. Thus, as full financing through the payroll tax as possible makes the cost of OASDI readily apparent and therefore serves as a highly desirable cost control.

The "person on the street" may often favor the idea of a government subsidy to OASDI under the mistaken view that the government "has money of its own" or, somewhat more economically sophisticated, that the monies so obtained come only from the wealthy. Actually, due to shifting of taxes and planning of incomes, general revenues are not derived solely (or even largely) from the highest-income groups. Also, taxes levied on large corporations are passed along to the general public (i.e., primarily the workers) in the price structure.

Those who advocate a government subsidy for OASDI propose several different ways of providing it, and also several different rationales. One approach, which is based on aesthetic logic and the practice of some foreign systems, is equal tripartite financing—that is, the government subsidy would be equal to 50 percent of the combined taxes from workers and employers.

Accrued Liability Argument

Another approach rests its case on the concept of "accrued liability for the initial group of covered workers." On this basis, the government should meet the higher cost involved for those who entered the system at the start at an older age compared with the cost for young new entrants in the future. Those who advocate this approach seek a parallel with the situation under contributory private pension plans, under which almost always the employer meets the costs for the initial unfunded accrued liability. On the whole, this procedure would involve about the same amount of general-revenue cost as the tripartite one.

Welfare Argument

A third approach is to attempt to separate the "welfare" elements from the "true insurance" ones, such as by assuming that the heavily weighted portion of the benefit formula is "welfare" and that the remainder is "insurance," which is actuarially purchased by the worker and employer taxes.[23] The latter is not so; the determination of what is purchasable, considering different ages and family structures, is not precise. Again, this procedure would involve about the same amount of general revenue cost as the tripartite one.

Cost Aspects

Any of these proposals for a government subsidy would require large expenditures from the General Fund of the Treasury immediately—somewhere in the neighborhood of $100 billion per year initially and increasing steadily thereafter. Obviously, this would be quite a strain and jolt to the federal budget. So, the advocates of this approach often suggest a gradual phasing-in to make their proposal more palatable politically and fiscally. For example, under the equal tripartite approach, the government subsidy might be 5 percent of the combined worker and employer taxes in the first year, 10 percent in the second year, and so forth, until reaching the desired goal of 50 percent in the tenth year.

In the congressional discussion in early 1978 about rolling back some of the tax increases resulting from the 1977 Act, it was proposed by some that general revenues should finance the disability and survivor benefits on the grounds that these were "welfare" rather than "insurance." These views were based on the fact that, in many cases, the insured worker had paid contributions for only a short time. Of course, this is erroneous reasoning, because such benefits involve more aspects of insurance than do the retirement benefits (which, for older persons at the start of the system, have a known high cost because the contingency is quite likely to occur).

23. The benefit formula for the PIA for those attaining age 62 in 1992 (or dying or becoming disabled before age 62 then) is, in essence, a flat amount of $224.46 per month for those with an AIME of at least $387 (and less than $2,333), plus 32 percent of such AIME. Thus, it might be said that the $224 is "welfare".

Current Existence of Government Subsidy

Some advocates of a government subsidy assert that, in fact, a government subsidy was already in effect before the 1983 Act. They pointed out that payments from general revenues were currently being made with respect to the cost of (1) deemed wage credits for certain military service, (2) hospital benefits under Medicare for certain uninsured aged persons who were initially blanketed-in, (3) uniform cash benefits for certain persons aged 72 and over who attained such age before 1972, and (4) the amounts with respect to persons covered by Supplementary Medical Insurance (SMI). They also assert that this is nothing new and was recommended by President Roosevelt at the inception of the plan, which is not the case, as pointed out earlier.

None of these instances is really a precedent for a government subsidy on a permanent, ongoing basis to the portions of the OASDI-HI program that are supported by payroll taxes. The military-service wage credits merely involve the government as the employer. The two blanketing-in benefit provisions for benefits for persons already aged when the new protection was added relate to special transitional groups, which will be phased out over a period of years. Finally, the SMI payments from general revenues are essential in order to have a *voluntary* insurance program with a uniform premium rate that is a good buy for all persons eligible.

Summary of Views

In summary, it seems to the author that it is very undesirable to inject general revenues into the financing of OASDI (or HI either) as a permanent matter—and certainly not any more than was done in the 1983 Act. To do so confuses the economic picture as to what the program really costs and who is paying for it. It is pure deception if workers—and employers, too—are convinced by the expansionists that a government subsidy will come out of somebody else's pocket and not their own in the long run. In any event, the inadvertent error in the 1983 Act, whereby an interest subsidy is given to the OASDI Trust Funds through crediting income-tax receipts on OASDI benefits to the trust funds well in advance of when they are collected, should be remedied.

The proposal to finance OASDI partially through a value-added tax, which is much less visible than payroll taxes, creates less awareness of costs on the part of the average covered individual and therefore, in the author's view, is not desirable.

In brief, if the clearly visible payroll taxes are viewed as being too burdensome, the American public should face up to the issue of whether it wants a social security program of the magnitude and scope of OASDI. Put that way, the author believes that the decision will be yes and that the financing by payroll taxes will be agreed to (even though somewhat reluctantly, as is the case with any tax or other expenditure of one's funds).

Do Young Persons Get Their Money's Worth?

From time to time, individuals question whether OASDI benefits are a good buy for an individual compared with what could be obtained by investing the OASDI taxes in a private insurance program. Invariably, because of the nature of OASDI, the individual who is middle-aged or older when first entering the program will receive far more from it than could be obtained under a private insurance program with premiums equal to the OASDI taxes.

When the young new entrant is considered, different analysts obtain quite different results. Some find that young new entrants receive very poor treatment under OASDI, whereas others conclude that they are treated fairly (even though not receiving the actuarial windfalls that older persons receive). The reason for this wide divergency of findings generally rests entirely on the assumptions made. Some specific computations of this type are presented in Appendix 5-3.[24]

Probably the most important assumption is whether the analysis should be made only on the basis of the employee tax or whether the employer tax should be included as well. Obviously, under the latter approach, the purchasable benefits from the private source will be significantly larger, and the comparison with OASDI will be much more favorable for the private approach.

As discussed earlier in this chapter, many economists assert that the employer tax is really paid by the employee and should be so as-

24. For a more extensive and thorough analysis of this subject (which is also related to older individuals), see Orlo R. Nichols and Richard G. Schreitmueller, "Some Comparisons of the Value of a Worker's Social Security Taxes and Benefits," Actuarial Note No. 95, Social Security Administration, April 1978. In the author's view, this excellent study has certain limitations. The reader should not place too much emphasis on the case of a worker with an eligible wife, because, for the young new entrant, about 85 percent of the wives will have benefits on their own earnings record. Also, account should be taken of the higher tax rates which will be required ultimately due to the system then being estimated to be not in actuarial balance and of the situation for young new entrants in the future when tax rates are higher than in the next few years (if the additional financing is not through payroll taxes, then individuals will have to provide the necessary funds through some other form of taxes). Another thorough analysis, based on examining the situation at attainment of age 65, is contained in Robert J. Myers and Bruce D. Schobel, "An Updated Money's-Worth Analysis of Social Security Retirement Benefits," *Transactions*, Society of Actuaries, 1992.

signed. However, it seems more logical that any such comparison should be confined only to the employee tax. Even though the employer taxes might, in the aggregate, be considered part of the remuneration of employees and thus fully assignable to them, it does not follow that the assignment should be on an individual-by-individual basis according to wages. Rather, it would be reasonable (as is indirectly done in most private pension plans) to make such assignment of the employer tax on a risk basis (i.e., much more proportionately for older and high-cost workers than for younger and low-cost workers).

Other assumptions for such analyses are also important. For example, there might be considered only single workers who retire (if they survive) at a relatively advanced age. Under such circumstances, the purchasable annuity under private insurance would compare very favorably with the OASDI benefit. But this does not seem a fair approach, because there should be considered a broad spread of individuals with all types of family compositions and all ranges of retirement ages. Also, for married individuals, consideration must be given to the likelihood that the spouse has a benefit based on his or her own earnings record. Similarly, comparisons should not be restricted solely to high-paid individuals.

Still another important assumption concerns what will be the future course of the benefit level. This is especially significant now that automatic-adjustment provisions have been incorporated into OASDI, so that an assumption needs to be made about the future trend of the cost of living (which controls the future benefit adjustments).

Another assumption—and one that is closely related to the previous one about the future course of the benefit level—is the rate of interest to be used in calculating what private insurance benefit protection can be obtained. Frequently, comparisons are made on the basis of what private insurance could theoretically be obtained, rather than actual policies, because the latter seldom (if ever) can duplicate exactly the OASDI benefit protection to be compared. This is especially so with regard to the automatic-adjustment provisions that keep the benefit amounts up to date with changes in the CPI, compared with the level-payment annuities available from insurance companies.[25] If a low interest rate is used in the calculations, this will make the OASDI benefit protection appear much more favorable, and vice versa. The interest rate that should properly be used is the sum of (1)

25. If the CPI increases at the rate of 4 percent per year, a level-payment annuity of $504 per month would be needed to be equivalent to an OASDI benefit that started out at $400 per month at age 65 (based on a life expectancy of 15 years). If the CPI increases were assumed at 6 percent per year, the corresponding level-payment annuity would be $559.

the rate of inflation of prices assumed and (2) the "real" interest rate; in previous years, this was generally accepted as about 3 percent, although currently some people consider it to be as low as 2 percent.

Moreover, there is an important relationship between the two foregoing assumptions—future level of OASDI benefits and interest rate. Some expansionists argue that the program is always a good buy for the younger worker, even if the combined employer-employee tax rates are considered, because there will be significant increases in the benefits over future years as the automatic-adjustment provisions apply.

The error in their analysis usually lies in the fact that they select a relatively low interest rate, such as 4 or 5 percent, for their calculations. In all logic, however, they should use an interest rate of 8 or 9 percent to conform with the dynamic economic assumptions they make about increases in the benefit level. If this were done, then OASDI would be shown to be a poor bargain for young new entrants when the combined employer-employee tax is considered, but a reasonably good buy when only the employee tax rate is considered. After all, as long as OASDI is financed almost entirely by payroll taxes, it is no "magic machine" that can produce benefits that are an actuarial bargain for everybody when the entire tax rate is considered individually allocable to each employee.

On the other hand, some critics of the OASDI program develop assumptions under which the taxes will purchase much larger benefit protection under private insurance than is actually obtained under OASDI. Frequently, these comparisons use the combined employer-employee tax rate, which does not seem a valid approach.

Sometimes such a result—although of a much lesser degree of superiority of the privately based benefit over OASDI—can be shown when only the employee tax rate is considered. However, such comparisons are usually invalid because they are incomplete on account of ignoring certain factors such as the availability of auxiliary and survivors benefits, or because they use an excessively high interest rate, or because they make some other assumption that is not reasonable.

In summary, it is impossible to make a truly precise comparison of the value of OASDI benefit protection and what could be obtained under private insurance by using the OASDI taxes as premiums. Only broad, general indications are possible, as given in the preceding paragraphs and in more detail in Appendix 5-3. The general statement can be made, however, that the average young new entrant receives somewhat more than his or her money's worth under OASDI if one considers only the employee taxes. On the other hand, if one considers the combined employer-employee taxes (which is not a totally valid approach), the reverse is true.

As for self-employed persons, who pay considerably more than the employee tax-rate, OASDI is not a bargain for young persons who expect to be in the self-employment category during their entire working lifetime. But, in this case, the result can be rationalized by asserting that part of what is paid is really an employer tax, pooled for the benefit of all workers under OASDI (just as is the case with respect to employees).

The gradual, phased-in increase in the NRA could be viewed as a reduction in benefits for current young persons and future new entrants—and thus a worsening of the situation as to whether they are getting their money's worth. However, more than offsetting this is the very strong likelihood that their retirement-life expectancy at age 67 will be greater than that of persons who are currently age 65. If such improvement in life expectancy does not occur, then lower tax rates than now scheduled could be possible, and this would improve the money's-worth picture. Nonetheless, the conclusions drawn are still valid for near-future new entrants, both when considering only the employee tax and when considering the combined employer-employeetax. Roughly speaking, a young new entrant at the present time on the average will pay with the employee tax for about 60–65 percent of the benefit protection. For the ultimate new entrant (for whom the contribution rate will likely be higher than now scheduled), this proportion may be about 80–85 percent, although it would exceed 100 percent for high-paid workers.[26]

Does OASDI Decrease or Increase Private Savings?

A frequently raised question among policymakers and economists is whether OASDI decreases or increases private savings. In turn, this has an important effect on whether there is adequate capital formation to support the nation's economic development.

Several economic studies and analyses of this matter have been made, with quite different conclusions reached. Martin Feldstein, then of Harvard University, believed that the productive capacity of the nation had been sharply reduced from what it would otherwise

26. This could be used as an argument for government subsidies to OASDI by those who favor this course of action for other reasons—namely, to "assure that people always get their money's worth." Such argument is especially applicable to high-paid workers. But the underlying fallacy of the entire argument is that the taxes to provide the government subsidy will come from the same people, even though in another way!

have been if OASDI taxes had not been levied. He estimated that these taxes reduced personal savings by about 50 percent, which money would have been used instead for economic development.[27] The weakness with that analysis is that it did not consider that, in the absence of OASDI, it is likely that there would have been a huge public assistance program. Such program would have to be financed by taxes of about the same magnitude as the OASDI ones, so that such monies would not have been available for economic development. Other economists, on the basis of empirical studies, are not at all convinced that OASDI taxes have reduced private savings.[28]

In 1980, two economists from the Social Security Administration, Dean R. Leimer and Selig D. Lesnoy, presented a paper to the American Economic Association that disclosed a fundamental flaw in Feldstein's computer program (see *New York Times*, October 5, 1980). When corrected, his econometric model showed that Social Security had no effect on personal savings. Feldstein, however, contended that, when other factors and later developments were taken into consideration, his original conclusions were still valid in general, although not necessarily of the same magnitude.

Louis Esposito, an economist with the Social Security Administration, reviewed four empirical studies which investigated the effect of social security programs on aggregate public savings.[29] He concluded that "the empirical results do not support the hypothesis that the social security program decreases private savings."

Another possibility for increasing savings in the private sector would be to permit young new entrants to the labor market to opt out of OASDI if their employer-employee taxes are used in a private pension plan or other economic-security vehicle in the private sector. Or this could even be done on a mandatory basis. The results would be both to increase private savings and very likely to result in greater benefit protection for those involved (at least in the aggregate even though not in all aspects). The drawback and difficulty of this approach are the tremendous financial burden remaining for OASDI with respect to those who remain in it, even as it "withers on

27. See Martin Feldstein, "Social Security, Induced Retirement, Aggregate Capital Accumulation," *Journal of Political Economy*, September–October 1974.

28. For example, see Alicia H. Munnell, *The Effect of Social Security on Personal Saving* (Cambridge, Mass.: Ballinger Publishing, 1974); Robert J. Barro, *The Impact of Social Security on Private Saving* (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1978); and Henry J. Aaron, *Economic Effects of Social Security* (Washington, D.C.: Brookings Institution, 1982).

29. Louis Esposito, "Effect of Social Security on Saving: Review of Studies Using U.S. Times-Series Data," *Social Security Bulletin*, May 1978. The authors of the studies reviewed responded in "Social Security and Private Saving: Another Look," *Social Security Bulletin*, May 1979.

the vine"—and then who would meet such burden and how they would do so?

Burden of OASDI-HI Taxes versus That of Income Taxes

One of the widely stated myths about the OASDI program is that "a majority of tax payers pay more in OASDI-HI taxes than they do in personal income taxes." This is so *only* if one considers that the employer tax "belongs" entirely to each employee individually (rather than being pooled for the benefit of all covered workers). For one thing, the employer tax is not counted as part of the employee's income for income-tax purposes.

In the author's view, only the direct employee taxes should be considered in comparisons with personal income taxes. When this is done, and when only federal income taxes are considered, the proportion of families who pay some OASDI-HI taxes, with such taxes being more than their federal income taxes, has been estimated to be 38.0 percent for 1990 (as against 31.2 percent for 1977); if the employer OASDI-HI taxes were included (wrongly, in the author's opinion), the proportion would be 76.6 percent in 1990 (and 57.8 percent in 1977).[30] Many of these are young, single-person families with no income-tax liability at all—a group for whom this situation does not seem a matter of very much concern.

A quite different picture of the relationship of OASDI-HI taxes and income taxes appears when the earned income credit applicable to low-earnings individuals (see page 507) is considered. As an example, consider a couple with one child who, in 1990, had a total earned income of $14,000 and no other income. The employee OASDI-HI tax was $1,071, and the income tax was a refund of $263 (after taking into account the earned income credit of $625). This would seem to be a case where the OASDI-HI tax was far larger than the income tax. However, if the earned income credit was considered to be a reduction in the OASDI-HI taxes rather than a reduction in the income tax—as the author believes is the more reasonable approach—the situation is reversed, and the income tax ($362) is larger than the net OASDI-HI taxes ($293).

30. As estimated by the Congressional Budget Office ("Background Materials on Federal Budget and Tax Policy for Fiscal Year 1991 and Beyond," Committee on Ways and Means, House of Representatives, WMCP, 101-21, February 6, 1990, page 24). For further factual details on the subject of relative burdens of OASDI-HI taxes and income taxes, see Benjamin Bridges, Jr., "Family Social Security Taxes Compared with Federal Income Taxes, 1979," *Social Security Bulletin*, December 1981; and Bruce D. Schobel, "A Comparison of Social Security Taxes and Federal Income Taxes, 1980–90," *Social Security Bulletin*, December 1981.

Making OASDI Be an Instrument for General Fiscal and Economic Planning

At times, people have proposed that the OASDI program should be designed or changed so as to be an instrument for general fiscal and economic planning. The purpose for this might be, for example, to increase national savings or to combat inflation—or, conversely, to restore economic prosperity.

Dean J. Douglas Brown of Princeton University, who was one of the leaders in the initiation of the OASDI program and in its subsequent development over the years, said cogent words about the necessity for not distorting the OASDI system by allowing it to become an instrument of fiscal policy. In his book *An American Philosophy of Social Security* (Princeton, N.J.: Princeton University Press, 1972), he stated:

> It has been strongly urged by succeeding Advisory Councils that this posture of neutrality be maintained despite the growth of social insurance income and disbursements. The repeated recommendation that the size of the reserve be kept as close as possible to one year's benefit payments is based, in large part, on this concept of neutrality. Pronounced changes in social security reserves through unwise planning of contribution schedules or benefit disbursements were to be avoided to limit any inflationary or deflationary effects on the general economy. Advisory Councils have likewise urged that the fiscal agencies of the government avoid any tendency to interfere in the determination of social security policy for the ulterior purpose of easing their current fiscal problems. This trade-off of neutrality on the part of two major agencies of government which deal with large flows of funds in respect to each other's policies is of great importance in maintaining the integrity of the American social insurance system. If the system became an instrument of fiscal policy, the precious confidence of the American people would be undermined. The system in its own normal operations provides a stabilizing factor in the American economy. But its primary purpose is to provide security to the individual American worker and his family. It should not be distorted into a mechanism for the manipulation of fiscal balances.

Appendix 5-1

History of the Retirement Age under OASDI and Possible Future Changes

Retirement Age Initially Chosen

The original Social Security Act (1935) established age 65 as the minimum age at which retirement benefits could be obtained. It contained—as has all subsequent legislation—a provision such that those engaged in substantial employment could not receive full benefits until they retired (the so-called earnings or retirement test). Why was age 65 selected? Some have asserted that this was done because Bismarck chose this age in the 1880s when he established in Germany the first social insurance system dealing with retirement benefits. That fact is, however, that such original age was 70, and the German system did not use age 65 (which it does currently) until a change was made during World War I.

Actually, age 65 was selected for OASDI as a compromise. Some private pension plans in the mid-1930s had such a retirement age, although many others used age 70 (e.g., some railroad plans). The Townsend Plan (which had great support at the time the Social Security Act was being considered) proposed universal pensions at age 60. The result of the considerations that led to the Social Security Act was that age 70 seemed too high, while age 60 was too low from a cost standpoint. Accordingly, the intervening "round" figure of 65 was chosen.

Some of those who favored a lower age than 65 in the mid-1930s used fallacious arguments. For example, they stated that, because the expectation of life at birth at that time was less than 65, nobody would live to draw a pension. The fallacy of this was, of course, quite easy to point out—namely, that there were at that time about 8 million people aged 65 or over!

Reduction in Retirement Age for Women in 1956

The 1956 Act lowered the minimum retirement age for women to 62, but with reduced benefits for women workers and wives, so that the Normal Retirement Age (NRA), at which unreduced benefits were payable, remained unchanged. At that time, a number of private pension plans had lower retirement ages for female workers than for males—generally under the dual theses of chivalry and alleged lesser efficiency of older women than older men. With respect to the latter, there is, of course, the anomaly that women live longer than men.

The change made in 1956 was not, however, based on this differential as it existed in some private pension plans, but rather it came about through a "domino" effect. There was pressure for paying benefits to widows at a lower age than 65, because of the natural sympathy for this category, as well as because of the difficulty that newly created widows at the older ages had in obtaining employment.

Furthermore, it was argued that, because wives were generally somewhat younger than their husbands, wife's benefits should be available below age 65, so that the worker who retired at age 65 would have the larger family benefits immediately available. It was then argued that, if widow's benefits and wife's benefits were available before age 65, the same should be true for the female worker, because she had actually contributed toward her own benefit and should be at least as favorably treated as her nonworking married "sister."

Reduction in Retirement Age for Men in 1961

In the 1961 Act the minimum retirement age for men was reduced from 65 to 62, again with reduced benefits for workers and husbands. This was done, not because of pressure for equal treatment, but rather because there was considerable unemployment in the Appalachian coal-mining area and an influential senator from West Virginia (Senator Robert Byrd) pushed for this change. He was especially aided by the fact that this was a "no-cost" matter. It might have been expected that the "domino" effect would have once again taken over and that the minimum age for wife's benefits would have been reduced, so that a man retiring at age 62 would be more likely to have wife's benefits available. Such, however, was not the case, although the minimum age for widow's benefits was reduced to 60 by the 1965 Act.

Proposals to Increase Normal Retirement Age before 1983 Act

In the mid-1970s, beginning with the 1975 Advisory Council on Social Security, there was some advocacy of increasing the NRA. This was argued for on two grounds. First, the future demographic structure of the country will be significantly different than it has been in the past, in that there will be relatively fewer persons at the working ages under 65 and relatively more persons at ages 65 and over. Second, with decreasing mortality and improving general health conditions, people can (and desirably should) work longer.

Despite these arguments, the experience in the recent past indicated an opposite tendency. Average retirement ages (both as reflected by OASDI statistics and as shown by the increasing pressure for early-retirement provisions in private pension plans) had been steadily falling. It is possible, however, that a change in this trend will occur in the next two decades, as labor-market shortages show up and as general health conditions improve. In the short run, the fear of continuing inflation may also reverse the trend toward early retirement.

Some would argue that the legislation prohibiting mandatory retirement by employers before age 70 is another good reason that the minimum retirement age under OASDI should be increased.[31] This

31. This change, however, is believed to have had some effect on the average retirement age under OASDI. In the 1978 OASDI Trustees Report, it was estimated that the

does not really follow logically. Many would assert that employees should "have the best of all worlds" by being able to either retire as early as they want or stay working as long as they want.

Most proposals for increasing the NRA under OASDI do so only after some number of years, and then would phase the increase in gradually (although a few would start immediately, but on a gradual phasing-in basis). This would seem to be the only proper course of action, because then people would know well in advance how to make their retirement plans. All proposals have linked the increase in the NRA for workers with the NRA for spouses and widow(er)s.

One possible procedure for raising the NRA to reflect increases in longevity would be to do so on an automatic-adjustment basis tied to the expectation of life at age 65 (as is done in several ways under OASDI for changes in economic elements). Under this approach, the expectation of life at age 65 in the U.S. Total Persons Life Table for 1939–41 (12.80 years) might be taken as the base.[32] Then, after a subsequent life table prepared from a decennial census became available, the NRA for the 30th year after the census year would be established at the age in the new life table (rounded to the nearest one-fourth year) at which the expectation of life is 12.80 years.

For example, the 1979–81 life table shows an expectation of life at age 71¼ of about 12.80 years. If such a procedure had been followed in 1983, the NRA would have been promulgated at 71¼ for persons attaining age 65 in 2011 and would be graded into this by steps of 7½ months, beginning with 2001. Subsequently, at each new determination, there could be a phasing-in between the age promulgated for 30 years from the particular census date and the age promulgated in the previous determination for 10 years earlier.

If it were felt that such an increase in the NRA to about 71 in 2010, with gradual grading over the previous decade, was too large from a political or other viewpoint, a base period later than 1939–41 could be selected. In any event, people should have considerable advance knowledge of the terms under which their retirement provisions will be applicable.

The next question to be dealt with, if the NRA is increased, concerns what should be done about the age at which reduced early-retirement benefits would be available. One approach would be to leave

long-range average-cost of the program would be reduced by 0.08 percent of taxable payroll by this legislation.

32. Although the author is strongly opposed to the use of unisex life tables for the actuarial valuation of pension plans and purchasable annuities, their use here is appropriate because there should, as a matter of logic and national policy, be the same minimum retirement age for both men and women.

this age unchanged at 62. The difficulty is that then the appropriate reduction factor, if maintained on an actuarially equivalent basis, would be quite large—namely, about 35 percent if the age for full benefits were 68.

The other approach would be to move the minimum age for early-retirement benefits up in tandem with the NRA. In other words, eventually early-retirement benefits could not be obtained before age 65 if full benefits were not available until age 68. Those who have a "static" viewpoint, and thus oppose any increase in minimum retirement ages (by not recognizing the dynamic nature of this element, including general mortality and health conditions of the aged), would particularly oppose not having early-retirement benefits available at as low an age as 62. They would assert—based on past and current experience, but not necessarily the likely future experience—that many people are forced for one reason or another to retire in their early sixties.

One counterargument is that, if such early retirements were caused by disability, then disability benefits would be available at the ages between, say, 62 and 68. Some might argue that, as an offset to raising the minimum age for early-retirement benefits, there should be a more liberal definition of disability for those aged 60 and over. This, however, is fraught with certain dangers of overly liberal determinations of disability. In addition, there would be the notch problem of having a liberal definition above a certain age and a much more restrictive one at lower ages, thus causing pressure to move down the limiting age.

The best argument for raising the NRA is that this element should not be considered static any more than economic elements such as price and wage changes are so considered. Longevity has greatly increased since the original Social Security Act in 1935 prescribed age 65 as the NRA. This is clearly evident in the following figures from pertinent U.S. Life Tables, plus projections made by the Social Security Administration (as shown in its Actuarial Study No. 89, *Life Tables for the United States: 1900–2050*, by Joseph F. Faber and Alice H. Wade, December 1983):

	Expectations of Life at Age 65	
Year	*Males*	*Females*
1935	11.93	13.21
1980	14.04	18.36
2000	15.65	20.66
2050	17.45	22.91

If age 65 was the "right" NRA in 1935, then the corresponding ages in later years (i.e., the age at which the expectation of life is equivalent to that at age 65 in 1935) are:

Year	*Males*	*Females*
1980	68.8	73.4
2000	71.2	75.6
2050	74.1	78.6

Additionally, if the assumption is made that age 65 is the "right" age as of 1980, then the equivalent ages in later years are:

Year	*Males*	*Females*
2000	67.6	68.2
2050	70.4	71.1

The proper method of determining the "right" NRA could use 1935 as the base. Under this approach, the proper age for males is 69 now and 74 ultimately, whereas for females the corresponding figures are 73 and 79. However, it almost goes without saying that, considering the political necessity for equal treatment by sex, there must be the same NRA for both men and women. Taking this into account, and also considering the alternative that the base for measuring the "right" age should be the present time, an eventual figure of 70 would be quite reasonable—if anything, somewhat on the low side.

Increase in Normal Retirement Age in 1983 Act

As described in Chapter 3, the NRA was increased from 65 to 67 by the 1983 Act, on a deferred (and then gradual) basis; details of the procedures used are given in Chapter 2. Those who opposed this change hope to have it repealed before it first becomes effective (in 2000), especially if the financial status of the OASDI program becomes very favorable in the 1990s. Such a situation could occur as a result of the relatively low-cost demographic structure of the population then, along with the increased tax rate in 1990, if economic conditions are good.

The arguments would then be as to how to use the large emerging excesses of income over outgo that would occur if no changes are made in the law. These excesses could be allowed to build up colossal fund balances, as shown in Chapter 10 (which the author believes to be undesirable). Or they could be used to liberalize benefits, for example, by not increasing the NRA beyond 65. Or they could be avoided by temporarily reducing the tax rates below those now scheduled (which the author favors).

On the other hand, for the demographic reasons presented previously, some believe that the NRA should eventually be higher than 67. This could be accomplished by following the procedure in present law to raise the NRA to 66, but then to continue increasing it without the leveling-off for 12 years before once again increasing it. Of course, if after a decade or so, demographic and economic conditions are not such as to warrant raising the NRA, this should not be done. Under such circumstances, the national economy would have to meet the additional costs involved, through higher tax rates. Even so, it is more desirable to plan on increasing the NRA well in advance and then not do it than to have the reverse situation of not scheduling an increase in advance and then having to do so on a crash basis.

The author also believes that an automatic indexing procedure for ultimately determining the NRA (at least in part)—as was done in the initial Senate bill in the development of the 1983 Act (as described in Chapter 3)—would be desirable.

Appendix 5-2

Various Approaches to Provide Equal Treatment by Sex in the Computation of Social Security Benefit Amounts

The Social Security Administration, in 1978, described eight different approaches for providing equal treatment by sex in the computation of OASDI benefits (these were developed by the Department of HEW Task Force on Treatment of Women under Social Security).[33] Actually, in some instances what is viewed as inconsistent or inequitable treatment does not involve any sexual discrimination, but rather differences between families where only one spouse works (generally the husband) and families where both spouses work. Further involved, then, is the question of the treatment of single workers versus married workers. As a result, dilemmas are often present, and by solving one problem, others may be created. Then, too, OASDI is sometimes criticized for situations that are primarily caused by other elements, such as inequitable hiring policies, the setting of wages, or education.

A number of proposals involve splitting the earnings records between spouses. This general theory has appeal, and it would work out

33. See *Social Security Bulletin*, May 1978, pp. 38–39.

quite well *if* spouses were always the same age, always survived to retirement age, and never were divorced. However, under all of the various other circumstances that can occur, gross inequities, anomalies, and administrative problems arise.

The first proposal would give some recognition to the earnings of the spouse with lower earnings by providing an *additional* so-called working spouse's benefit equal to 25 percent of the smaller of such spouse's own benefit or the benefit coming from the other spouse's earnings record. Under the present law, the spouse receives only the larger of the preceding two benefits. This is based on the social-adequacy principle that a single benefit (the larger of the two) is sufficient. From an individual-equity standpoint, however, the spouse involved often feels that this procedure is unfair, especially when compared with the procedure for a spouse who never worked and paid OASDI-HI taxes, but who will nonetheless receive exactly the same benefit (namely, that derived from the other spouse's earnings). This proposal thus would provide some recognition of the possibly small benefit "earned" by the spouse with the lower earnings record. In the author's opinion, this is the most desirable of the several proposals (and was contained in the so-called Republican Alternative Bill put forth at the time the House Ways and Means Committee was developing the 1977 Act).

The second proposal would involve combining the earnings of married couples at retirement, essentially moving the earnings record of the spouse with the lower earnings to the record of the other spouse. This plan, although apparently simple, has great complexity when the spouses are not the same age, or when one spouse has always had maximum earnings, or upon divorce, and so on. As with some other proposals, this one discriminates against single workers by making larger amounts available for couples.

The third proposal would increase all primary benefits by 12½ percent and decrease the basic spouse's benefit from 50 percent of the primary benefit to 33⅓ percent. This is a poorly disguised maneuver to expand the overall benefit level by increasing primary benefits and keeping the combination of primary and spouse benefits at the same dollar magnitude.

The fourth proposal would gradually phase out benefits for the spouse of a worker and provide child-care credits instead. The philosophy underlying this proposal seems to be that the lifestyle of women working in the paid labor market is the only proper one, and that women who choose to follow the traditional pattern of maintaining a home and raising children are following a practice that is obsolete and socially undesirable. The child-care credits would be only a sop and would be extremely difficult to administer; they might well produce inadequate benefits. In the author's opinion, instead of such credits, continuation of the present benefit protection arising from the husband's earnings record will provide adequately for homemakers and will undoubtedly not be considered repugnant by the individuals involved.

The fifth proposal would base benefits for a married couple on an average earnings equal to the total average of the two spouses and would eliminate spouse's benefits. Once again, this sounds very good as a broad general plan, but it results in anomalies and difficulties when the spouses reach retirement age at different times, or when death or disability occurs (and also in divorce situations).

The sixth proposal would provide earnings credits for homemaker services. One approach would permit elective coverage on the self-employment basis at a selected presumptive earnings level. This basis would very likely be completely unsuccessful, because few would elect to participate, and those who do so would adversely select against the system. The other approach would finance the credits through general revenues. Again, in the view of the author, there is considerable logic in such a general approach, but it would have serious administrative problems and often would not produce any substantial benefit results because the protection coming from the working spouse would be greater (also, if financed from general revenues, sizable new tax costs would be involved).

The seventh approach would be to divide the earnings credits equally between the spouses on a year-to-year basis. Each spouse would receive credit for the larger of (a) 50 percent of the couple's combined earnings or (b) 75 percent of the earnings of the higher-paid one. As with other earnings-sharing plans, a considerable number of anomalies and inequities would arise when disability or death occurs before retirement or when retirement occurs at different times for the two persons involved. For example, if the principal earner dies, the survivor benefits would be *lower* than at present, because they would be based on a lower earnings record.

The eighth approach was similar to the previous one, except that the combined earnings would always be equally divided on the basis of 50 percent of the combined earnings. Accordingly, it has the same drawbacks and inequities and anomalies.

One approach that was not analyzed by the task force has considerable merit. At present, the woman who is solely a homemaker for a number of years (such as while her children are under age 16) is disadvantaged in computing the AIME because of having to include a number of years with zero earnings. A change might be made so that additional dropout years in such computation are given for each full calendar year that the person was solely involved in homemaking services with a child under age 16 being present. Possibly, there should be the limitation that in no event would the AIME be computed over a shorter period than 10 years. Some administrative difficulty would be involved, as well as a definitional problem in determining the years when only homemaker services were involved (because of the situation of the person having a small amount of covered earnings due to supplementary occasional employment).

The 1977 Act mandated the Secretary of HEW to study proposals that would eliminate dependency as a factor in entitlement to spouse's benefits and result in equal treatment of men and women under OASDI. The resulting report concluded that the program was unfairly discriminatory against women and presented several options for corrective action.[34] Two broad-scale options were developed.

The first option was an earning-sharing plan of a broad nature, with such sharing to be done in all circumstances except for disability benefits and child-survivor benefits. The second option involved the complete restructuring of the OASDI system by converting it to a two-tier (or double-decker) basis, under which a flat benefit on a demogrant basis would be paid to all persons and an earnings-related benefit (on a proportional basis) would be paid in addition. The proposals were made under the constraint that the overall cost of OASDI should not be increased. As a result, the benefits for one-worker families would be lowered in order to increase those for two-worker families. Consequently, supporters of the "traditional" family were vigorously opposed to these proposals.

The foregoing report also discussed a number of limited options to solve what were perceived to be problems. These included OASDI earnings credits for work as a homemaker, payment of part or all of the smaller dual benefit (benefit on own earnings record or spouse's benefit), child-care dropout years in computing the AIME, and an "adjustment" monthly benefit payable for one year to widowed spouses under age 60 who do not have an eligible child present.

The 1983 Act provided for a study to be made by the Secretary of HHS (to be completed no later than July 1, 1984) as to how adequate and equitable earnings-sharing proposals could be developed and implemented (and as to their cost aspects). The author believes that this task is as impossible as precisely trisecting an angle or expressing pi as an integer.

34. U.S. Department of Health, Education, and Welfare, *Social Security and the Changing Roles of Men and Women* (Washington, D.C., HEW, February 1979).

In summary, the problems addressed by the various foregoing proposals are not nearly as significant as some people believe. Some of the situations arise because of factors external to OASDI, and the latter should not be called upon to solve them. In many ways, any action taken may correct one problem but make another worse. Any changes made should not be solely to advantage women who are working in the paid labor force and, at the same time, disadvantage women who prefer to be homemakers.

The present basis has worked out well in the past and will continue to operate in a reasonable manner. In the author's view, there is no reason why the homemaker has any more loss of personal dignity if her separate benefit check is said to be based on her husband's earnings record than if the same result occurs indirectly by her receiving part of his earnings as an earnings-record entry. One change that might be made to provide more nearly equal treatment and to allay any feelings of loss of dignity would be, at a couple's request, to divide the total family benefit payment each month equally between the spouses (even though it might be computed otherwise—e.g., 100 percent of the PIA for a working spouse and 50 percent for the other spouse).

Appendix 5-3

Comparison of Actuarially Purchasable Benefits with Actual Ones

Frequently, interest is expressed in the relationship of the size of OASDI retirement benefits that could be actuarially purchased with the taxes to the actual amounts payable. Often this interest is directed to the matter of whether the young workers get their money's worth from the taxes they pay. Frequently ignored is the value of the disability and survivor protection which is available before retirement age.

This is an apparently simple question, but it is very difficult to answer—perhaps even impossible to respond to in an accurate manner. For one thing, as discussed in this chapter, there is the important question whether, for an individual, the employer taxes paid on wages "belong" to the employee, or whether only the employee taxes should be considered in the analysis. Then, too, the comprehensive and complex benefit structure of OASDI (with its heavy reliance on auxiliary benefits, earnings test, and provisions preventing duplicate benefits) is difficult to analyze or to match against private insurance coverage.

It is almost obvious that persons who retired in the early years of operation of the OASDI system received tremendous actuarial "windfalls" because of the necessary social-adequacy nature of the program. The extent thereof will now be considered.

Analysis for 1935 Act

Under the original 1935 law, a person who retired at age 65 at the earliest possible date (January 1942) would have received a monthly benefit of $25 if maximum covered wages ($3,000 per year) had been attained. The employee taxes paid would have been $180 ($30 per year during 1937–39 and $45 per year during 1940–41). Based on the U.S. Total Males Life Table for 1949–51, at an interest rate of 3 percent (a reasonable rate then), the present value of the benefits as of January 1942 was $3,009 for this case. The accumulation of the employee taxes to January 1942 at 3 percent interest was $193. Thus, the employee taxes "purchased" only 6.4 percent of the benefits, and the individual received a "windfall" of $2,816.

Next, consider the case of a similar individual under the 1935 provisions, except that he or she had the minimum wages needed to qualify for benefits ($1 of wages in both 1941 and 1942 at a tax rate of 1½ percent, and a total of $1,998 of wages during 1937–39 at a tax rate of 1 percent). The benefit would have been $10 a month, and its present value for a male was $1,204. Thus, the taxes accumulated at interest, amounting to $23, "purchased" only 1.9 percent of the benefits. The "windfall" for this low-earnings individual was $1,181, or only 42 percent of that for the maximum-earnings person.

At times people assert that individual equity was present to a considerable extent under the 1935 Act and that little redistributional effect between income levels and between generations was intended. That this was not so can be shown by considering two cases—a low earner ($600 per year) aged 60 in 1937 and a maximum earner ($3,000 per year) aged 22 in 1937. The latter would contribute a total of $4,080 in her or his 43 years of coverage, or 113⅓ times the $60 contributed by the former. At the same time, the monthly old-age benefit at age 65 for the young maximum earner amounting to $85 would be only 5⅔ times as high as the $15 benefit of the old low earner. This would hardly be an individual-equity situation (and would be even less so if the time value of money were taken into account).

Analysis for 1939 Act

The 1935 provisions never went into effect. Instead, those of the "more socially adequate" 1939 legislation became operative for retirements after 1939. Consider the case of a man retiring at age 65 in January 1940, with a wife the same age. For the person with maximum covered wages, the monthly benefit was $41.20 for the worker and $20.60 for the wife ($30.90 if she became a widow). These benefits had a present value of $8,264 as of January 1940 (on the same basis as that in the previous example). At the same time, the accumulated employees taxes ($90 in total) amounted to $94, so that they "purchased" only 1.1 percent of the benefits, and the "windfall benefit" was $8,170.

For such an individual with the minimum amount of wages to qualify for benefits (with 6 quarters at $50 each), the monthly benefit was $10 for the worker and $5 for the wife ($10 if she became a widow). These benefits had a present value of $2,119 as of January 1940. The accumulated employee taxes ($3 in total) amounted to $3.15, so that they "purchased" only 0.15 percent of the benefits, and the "windfall benefit" was $2,116, or only 26 percent of that for the maximum-earnings case.

In actuality, beginning in 1950, the benefits were increased for the 1940 retiree and his wife (and for June 1979 amounted to $259.00 for the worker with maximum earnings if he was still alive and to $129.50 for the wife or $259.00 for the widow). If the increases that actually took place were taken into account, the "purchased" ratio would have been even smaller (although not very much so, because the same benefit rates were maintained for the first decade and because of the discounting effects of mortality and interest).

The last survivor of the approximately 32,000 persons who were paid benefits for January 1940 as retired workers aged 65 or over died in 1981.[35] By an unusual circumstance, the beneficiary designated as being the first person to receive a Social Security check, because it bore the number 1, was Ida Fuller of Brattleboro, Vermont, who lived until January 1975, just attaining age 100. Her initial monthly benefit for January 1940 was $22.54, which was close to the average benefit then awarded, and the one for December 1974 was $109.20. The total benefits which she had been paid through December 1974 amounted to $20,884.52, as compared with the total employee taxes which she had paid of only about $22.

Analysis for Maximum-Earnings Case Retiring in 1991

Next, consider the situation for a man with maximum covered wages in every year since age 18 (in 1944) who reaches age 65 at the

35. This individual, William Howard Reamer, was aged 106 at the beginning of 1980 (see *OASIS*, Social Security Administration, April 1980).

beginning of 1991 and who retires then. Only the OASI employee taxes will be considered because it might be said that the DI taxes "bought" the disability-benefits protection that he had and that the HI taxes "buy" the HI benefits protection that he will have in the future. This procedure ignores both the survivor-benefits protection that he may have had in the past and, conversely, the considerable "forfeiture" that he would have had in the past if he had died without leaving survivors who would have received benefits on his wage record, which elements are at least partially counterbalancing.

The OASI taxes for this case have been accumulated at an assumed interest rate of 3 percent for 1944–49, 4 percent for 1950–59, 5 percent for 1960–64, and 8 percent for 1965–90 (which are rates reasonably approximating those generally available in these periods). The total accumulation as of January 1, 1991, amounts to \$75,440.

The monthly benefit payable is \$1,022 if the man does not have an eligible wife. Assume that the CPI will increase at an average of 4 percent per year over his future lifetime. The present value of his monthly benefits, including the effect of the automatic-adjustment provisions, using the U.S. Total Males Life Table for 1979–81 (the latest available complete official table) at 6-percent interest (a rate consistent with the assumed CPI increases), is \$145,801. Thus his OASI taxes "bought" only 52 percent of his benefits, and his "windfall" benefit was \$70,361.

If the man in the foregoing example had been married to a woman of the same age (with no benefit based on her own earnings), the present value of the benefits would be \$269,663. Accordingly, only 28 percent of the benefits have been "bought" by the employee taxes, and his "windfall" benefit would be \$194,223.

The foregoing analysis has not considered the effect of the income taxation of OASDI benefits. For persons with very large other income, 50 percent of the OASDI benefits will be subject to income tax and, if they are in the top of the income-tax bracket, 15.5 percent of their benefits will be taxed away. Under these circumstances, the windfall benefits would be reduced to \$59,455 for the single man and \$164,118 for the married couple.

Analysis for Lower-Earnings Cases Retiring in 1991

Individuals currently retiring with wage histories less than the maximum level in all past years back to age 18, of course, have lower "bought" ratios than those derived above. Even if the employer tax is counted as well (which does not seem proper analytical procedure), the current retirees will not have "bought" their benefits—or even close thereto. For example, if the man who does not have an eligible wife in the foregoing example had wages each year in the past of only half the maximum, his monthly benefit would have been $619 per month (i.e., 61 percent of the $1,022 for the maximum-earnings case). The accumulated value of his taxes would have been $37,720 and the present value of his benefits would have been $88,308. Thus, he would have "bought" only 43 percent of his benefits and would have had a "windfall" benefit of $50,588.

It will be noted that although the "bought" ratio is lower for the low-paid man than for the maximum-earnings case, the latter *still* has a larger "windfall" benefit in terms of dollars (namely, $70,361 versus $50,588, so that the latter is 72 percent of the former). As indicated in the discussion in Chapter 1, this situation can, from some aspects, be subject to severe criticism. However, for the person with very high income, the windfall after allowing for the effect of the income taxation of benefits is not much larger than that for the low-paid case—$59,455, versus $50,588.

If the windfall for the worker without an eligible wife were computed on the basis of the combined employer-employee tax, the situation would be reversed—an excess of value of taxes over value of benefits of $5,079 for the maximum-earnings case (before considering the effect of the income taxation of benefits) versus a windfall of $12,868 for the lower-paid one.

Over the years, the foregoing situation will change significantly. The extent of windfall benefits will lessen, especially when the combined employer-employee taxes are considered and especially for the maximum-earner versus the lower-paid earner. In fact, in many cases, the reverse situation will occur—the accumulated value of the taxes will exceed the present value of the benefits (but not very often if only the employee taxes are considered).

Analysis for Current New Entrants

Finally, consider the situation for young new entrants currently—namely, a male who is covered from age 22 in 1991 until age 67 (the NRA for this birth group), with maximum earnings in all years. It is assumed that the interest rate is 6 percent, that wages rise at 5.3 percent per year, and that the CPI increases 4 percent annually. These economic assumptions are reasonably consistent with one another; the wage and CPI assumptions are those used over the long range in the intermediate actuarial cost estimates made in 1990, while the interest rate has in recent decades generally been about 2 percent higher than the rate of CPI increases. As to mortality assumptions, the U.S. Total Population Life Tables for 1979–81 rated down seven years (to allow for mortality decreases in the future) are used; for males, this produces an expectation of life of 18.9 years at age 65 (as compared with 14.2 years without such rate-down), a reasonable result. It is assumed that the tax rates presently scheduled will be applicable (although it is likely that over the long run they will have to be higher).

The monthly benefit payable to this new entrant at the time of retirement in 2036 would be $11,680 per month; the earnings in the year before retirement would be $518,100, yielding the reasonable benefit replacement rate of 27 percent. The accumulation of the employee OASI taxes to age 67 would be $1,548,000, while the present value of the benefits then if he does not have an eligible wife would be $1,984,000. Thus, he has "bought" 78 percent of his benefits, so that he would have a "windfall" of $436,000. On the other hand, if he has an eligible wife of the same age who does not have a benefit based on her own earnings record, the present value of the benefits would be $3,597,000, so he has "bought" 43 percent of the benefits and would have a "windfall" benefit of $2,049,000. In other words, the man without such an eligible wife would be somewhat above a "break-even" situation, whereas the man with an eligible wife would have a much larger value of benefits than his own taxes would have purchased actuarially.

It will, of course, be noted that if the employer taxes are included as well as the employee taxes, his "bought" benefit from the accumulated taxes would be considerably more than the actual one when he has no such eligible wife. Such a situation will generally be the case in the long range, because most women will then have benefits based on their own earnings credits, and these are larger than the wife's and widow's benefits coming from their husband's earnings record (or else are sizable "offsets" against their wife's and widow's benefits). But, in any event, it does not seem proper to so assign the employer taxes.

Effect of Varying Assumptions

The foregoing analysis is, of course, oversimplified. Varying a number of factors would change the results significantly. For example, a later age of retirement than 65 for those reaching age 65 in 1991 would reduce the "bought" ratios, but a lower age would have little effect because of the actuarial-reduction factors then applicable. Still another important factor is the interest rate.

Some people, in attempting to portray the OASDI program as a bargain for all persons, including new entrants, point out that the automatic-adjustment provisions provide a virtually unmatchable advantage. They inconsistently (and erroneously) use dynamic assumptions for wages and the CPI, but a low interest rate. If in the foregoing case of a current male new entrant without an eligible wife, an interest rate of only 5 percent had been used, the situation would be drastically changed. The accumulated OASI employee taxes would be $1,246,000 and the present value of the benefits would be $2,195,000. Thus, he would have "bought" only 57 percent of his benefit (instead of the 64 percent shown for the realistic interest rate of 6 percent). This comparison at 4-percent interest would make it appear that everybody always gets a bargain under OASDI—an impossible situation! Conversely, using the unrealistically high interest rate of 8 percent—that is, unrealistic in comparison with the wage and CPI assumptions—would "show" that people would be getting poor buys under OASDI; the "bought" ratio for the man without an eligible wife would rise well above 100 percent, to 150 percent (accumulated taxes of $2,480,000 versus present value of benefits of $1,651,000.

Conclusions

This discussion of actuarially purchasable amounts compared with actual benefits under OASDI can be summarized by saying that precise conclusions cannot be drawn in all respects. It is, however, obvious that those retiring in the early years, and even decades, of operation have received significant "actuarial bargains" whether only their own taxes are considered or whether the combined employer-employee taxes are considered. Such "bargains" have been greatest in relative terms for the lower paid and for those with eligible spouses and children, but in monetary terms more of a "windfall" has gone to the higher paid (and especially to those with eligible auxiliaries). The effect of the income taxation of benefits tends to change this situation for those with very high incomes, whose "windfalls" are significantly reduced thereby.

The long-range situation for current younger workers and for new entrants is less clear. If only the employee tax is considered—as the author believes is the proper procedure—and if the higher tax rates that seem likely to be needed in the long run do occur, current younger workers will receive their money's worth in average benefit protection and, in fact, somewhat more than this (i.e., they derive some of their benefit protection from the pooled employer taxes). However, if only high-salaried current younger workers are considered, there is probably about a standoff—that is, on the average, their taxes will somewhat more than "purchase" their benefits.