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SOCIAL SECURITY FUNDING

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A. HAEWORTH ROBERTSON

1. Major Amendments

Revised benefit formula
Increases in the contribution and benefit base
Tax rate increases

2. Financing Condition of Social Security After Amendments

Substantial reduction in the OASDI actuarial deficit
but significant remaining deficit after turn of
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MR. DONALD D. CODY: My prepared comments today are based on my forthcoming article in The Actuary entitled "Financial Appraisal of 1977 Social Security Amendments", which is a sequel to an October 1977 article requested by the Committee on Social Insurance of the American Academy of Actuaries to appraise various legislative proposals then under consideration. The details of the 1977 amendments will be discussed by Bob Myers and Haeworth Robertson. I will concentrate on the long-range financial projections.

I want to ask you to put aside the very real problems as to source of taxes and to concentrate primarily on future expenditures. Since taxes from various sources (or deficit financing) must be found each year for the Social Security expenditures in the same year, future taxes can be controlled only by controlling future benefits. More particularly, concern for sources of taxes in the near term must not lead to an expansion of aggregate benefit levels in the future. In my view, these benefits are already in the aggregate 15% above benchmark levels based on Social Security history before 1972. Even at present prices, 15% is \$15 billion a year; so, 15% is substantial.

The 1977 amendments have removed the coupling between inflating wages and inflating benefit rates. We now have a well-designed Average Indexed Monthly Earnings (AIME), which indexes earnings in each past year to current levels. The AIME is then applied to a Primary Insurance Amount (PIA) formula of three

terms, with bend points, permitting adjustment to future increases in wage levels. Also, about a 7% decrease in retirement benefit levels has been introduced to permit some recovery from an unintended upward creep caused by the coupling. So far so good.

However, the taxable earnings base schedule incorporates ad hoc jumps in 1979, 1980, and 1981, which were incorporated so as to lessen the increases in tax rate. In my view, these ad hoc increases in the earnings base are bad from a long-range planning point of view, because they represent an expansion of the Social Security system into an area better handled by private pensions, savings, and insurance. To the extent that they do not, pension funds available for capital investment will be decreased, to the detriment of our economy.

Let me develop these thoughts in detail. First of all, here are some background figures. Table 1 shows replacement ratios of PIA for the 12 months after retirement to taxable earnings in the year before retirement based on Scenario II of the 1977 Trustees Report. These ratios can be expected to be quite stable on all economic scenarios. The parenthetical figures in the "Maximum" column show the replacement ratios for employees who would have received credit for maximum earnings if the 1979, 1980, and 1981 jumps in the earnings base had not occurred, but rather only the changes due to the automatic-adjustment provision.

Table 2 shows the new tax rates. Half of these rates will be paid by employers and the other half by employees. The earnings base of the new law is shown in the final column, the parenthetical figures being the earnings base without the ad hoc increases. By 1981, about 91% of earnings in covered employment will be taxed, as compared with 85% today. Unfortunately, although current tax rates can be reduced because of this expansion of the tax base, about half of the savings is paid out later in increased benefits to the highest paid people.

The aggregate of expenditures relative to taxes over the next 75 years under the new law is shown in table 3. The peak of expenditures as a percentage of taxable earnings occurs in 2035 and is in excess of 17% of taxable payroll. This translates into 15% of total earnings in covered employment, and 7% of GNP. The third column shows that, while taxes received are higher than expenditures until after 2010, taxes as currently legislated are insufficient thereafter.

Prior to 2010, the trust funds build to quite high levels and this, to my mind, is politically and fiscally unreasonable. Taxes are unlikely to be levied to build this level of trust fund. However, even if they were, the expenditures would still have to be provided by taxes in the current year (or by deficit financing). The existence of trust funds of various sizes merely adjusts the level of general revenue financing, which equals interest on the bonds held in the trust fund and, of course, is used to pay benefits.

Let us turn to a summary of the excess of taxes over expenditures, as shown in table 4. While over the 75-year period the actuarial imbalance of 1.46% of taxable earnings is serious enough, the figure of itself does not sufficiently disclose the seriousness of imbalance, barring decreases in benefit levels, changing of normal retirement age, or other similar measures. We must anticipate entering the next century facing annual tax deficiencies gradually increasing to nearly 5% of taxable earnings by 2030. Expenditures would then be over 17% of taxable earnings.

The level of expenditures is quite sensitive to economic and demographic factors (inflation, productivity, mortality, and fertility), and the Social Security actuaries have analyzed various combinations of these factors into optimistic and pessimistic scenarios. The overall sensitivity from optimistic to pessimistic is shown in table 5. In the years 2027 to 2051, there is a pessimistic swing of 4% of taxable earnings above the 17% ratio of expenditures to taxable earnings on Scenario II and an optimistic swing of minus 2%.

Table 6 shows the effects of various factors in the scenario. You will notice that the most sensitive factors are the fertility rate and the productivity rate. The ultimate factors in Scenario II for inflation, productivity, and fertility are shown in parentheses in table 6, and the left and right columns in each section are, respectively, the changes for the optimistic and pessimistic Scenarios I and III.

It is evident that changes in productivity have a large influence on ultimate OASDI costs as a percent of taxable earnings, i.e., with productivity (real wage increases) less than Scenario II and with constant inflation, then taxable wages (and taxes) rise less rapidly than they would under Scenario II. In the absence of deterioration in productivity, greater inflation decreases costs as a percent of taxable earnings, i.e., with increased inflation and with constant productivity, then in-force benefits rise less rapidly than taxable wages because changes in economic factors are reflected earlier in the income to the system than in the outgo. Decreased fertility reduces the ratio of earners to retired persons, and hence can markedly increase the ratio of costs to taxable earnings; i.e., decreased fertility lowers taxable wages (and taxes), with deferred effect on benefits.

The difficulties of dependable long-range projections to 2027 to 2051 are dramatically illustrated by table 6. Caution as to liberalization of benefit levels is to be recommended because of these uncertainties.

In table 7, I show some of the benchmark figures from my earlier article in The Actuary. This article argued that for many years prior to 1979 one could interpret the intent of Congress as aiming at 80% of total earnings in covered employment for the tax and benefit base and at replacement ratios at about 52%, 40%, and 31% respectively for low, average, and maximum wages. On these intents the long-range ratio of expenditures to total earnings in covered employment would appear to be around 13%.

The 1977 amendments tax 91% of earnings in covered employment and provide for higher replacement ratios than the benchmark. On Scenario II, we can expect ratios of expenditures to total earnings in covered employment at 115% of the benchmark level. The corresponding ratio on the Carter Administration proposal, incidentally, would have been 120%.

Table 1

Year	(In 1977)	Replacement Ratios, Employees Retiring at 65 in Year with Earnings			OASDI Expenditures as Percent of Taxable Earnings
		Low	Average	Maximum	
		(\$5,000)	(\$10,000)	(\$16,500)	
1979		60%	47%	35%	10.3%
1985		53	42	23 (31)	10.5
1990		54	42	24 (31)	10.6
2000		54	42	26 (32)	11.0
2010		54	42	27 (33)	12.2
2030		54	42	28 (33)	17.1
2050		54	42	28 (33)	16.2

Employees with spouse aged 65 would have 150% of above ratios.

Table 2

	Taxes (% Taxable Earnings)				Earnings Base
	OASI	DI	HI	Total	
1978	8.55%	1.55%	2.00%	12.10%	\$17,700
1979	8.66	1.50	2.10	12.26	22,900 (\$18,900)*
1980	8.66	1.50	2.10	12.26	25,900 (\$20,400)*
1981	9.05	1.65	2.60	13.30	29,700 (\$21,900)*
1982-4	9.15	1.65	2.60	13.40	Increases proportionally to national average earnings
1985	9.50	1.90	2.70	14.10	
1986-89	9.50	1.90	2.90	14.30	
1990 and later	10.20	2.20	2.90	15.30	

* () Earnings Base on Scenario II
without ad hoc increases.

Table 3

OASDI Taxes and Expenditures (% Taxable Earnings)				
	<u>Taxes</u>	<u>Expenditures</u>	<u>Taxes Less Expenditures</u>	<u>Trust Funds (% Expenditures)</u>
1978	10.10%	10.86%	- .76%	37%
1980	10.16	10.11	.05	26
1985	11.40	10.45	.95	45
1990	12.40	10.58	1.82	81
1995	12.40	10.75	1.65	161
2000	12.40	10.96	1.44	231
2010	12.40	12.17	.23	297*
2020	12.40	14.99	-2.59	195*
2030	12.40	17.13	-4.73	0
2040	12.40	16.69	-4.29	
2050	12.40	16.18	-3.78	

* Omits negative DI Fund.

Table 4

<u>Excess of Taxes Over Expenditures</u> <u>(% Taxable Earnings)</u>	
1977-1989	.37%
1990-2001	<u>1.62%</u>
1977-2001 (1st 25 years)	.97%
2002-2026 (2nd 25 years)	-1.06%
2027-2051 (3rd 25 years)	<u>-4.29%</u>
1977-2051 (75 years)	-1.46%

Table 5Changes in Ratio of Expenditures to Taxable Earnings in Scenario II

<u>Period</u>	<u>Scenario I (Optimistic)</u>	<u>Scenario III (Pessimistic)</u>	<u>Scenario II Ratio of Expenditures to Taxable Earnings</u>
1977-2001	- .30%	.35%	10.60%
2002-2026	- .75	1.16	13.46
2027-2051	-1.73	3.88	16.69

Table 6

Changes in Ratio of Expenditures to Taxable Earnings in Scenario II

Period	Inflation (4%)		Productivity (1.75%)	
	-1%	+1%	+50%	-50%
1977-2001	.11%	-.10%	-.30%	.34%
2002-2026	.25	-.23	-.60	.67
2027-2051	.33	-.29	-.76	.85

Period	Fertility Rate (2.1)		Scenario II Ratio of Expenditures to Taxable Earnings
	+2 (Children per woman)	-4	
1977-2001	.01%	.01%	10.60%
2002-2026	-.27	.59	13.46
2027-2051	-1.16	2.88	16.69

Table 7

Financial Appraisal of OASDI

	Historical Benchmark	1977 Amendments	*Prior to 1977 Amendments
<u>Ultimate Ratio of Covered Employee Earnings To Total Earnings In Covered Employment</u>	80%	91%	85%
<u>Ultimate Replacement Ratio for Retired Earnings - Low</u>	52%	54%	(In 1977) (58%)
Average	40	42	(46)
Maximum	31	28 (33)	(33)
<u>Ratio of Expenditures to Total Earnings in Covered Employment</u>			
Year			
2030	13.7%	15.7%	*
2050	12.9	14.9	*
Index	100	115	*

* Omitted because of coupling.

MR. A. HAEWORTH ROBERTSON: During the general session on futurism this morning, one of the speakers spoke of the folly of making long-range projections for the Social Security program because the world will be different in the 21st century than it is now. He characterized persons who engaged in making such projections as living in an "Alice in Wonderland world". Last evening in the lobby of the hotel, I was talking with a senior executive of a very large New York insurance company about the assumptions being used to make long-range projections for the Social Security program. He dismissed any discussion of such assumptions as irrelevant since the distant future was only a "dreamland fantasy".

Our two colleagues are both right and wrong. They are right in recognizing that no one has the ability to make assumptions about the future which can be guaranteed to materialize. They are absolutely wrong in concluding that, since this is the situation, it is pointless to make such projections or to be concerned about the particular assumptions which are utilized.

I am not surprised that some members of the public are not interested in long-range projections. I am not very surprised that some of the elected officials (or even the appointed officials) are not interested, but I am absolutely appalled that there may be some actuaries who have ambivalent feelings about long-range cost projections.

I wonder how many actuaries would go to the Board of Directors of their life insurance company and say, "I have designed a fantastic new life insurance policy which has a wide array of benefits payable in the event of death, disability, or retirement. It pays superb commissions, and the agents are going out of their heads waiting to get permission to start selling. To top it off, it has surprisingly low premium rates which almost everybody can afford. As to the future cost of providing these benefits, the reserves we should establish, the future profits, and other things like that, I tried to make a few projections, but you know how hard it is to estimate lapse rates, inflation, sales volume, etc. so I recommend we just go ahead and start selling this little gem. In a few years, we will know how the profit picture is going to turn out."

Whereupon the Board Chairman would say, "You are a super actuary, Humperdinck, not at all like the many other actuaries we have terminated in the past because they insisted on looking to the future and making persistent warnings that we might go into bankruptcy. You are wasting your time as an actuary. You have all the qualities to be a fine vice-president for sales, and I am recommending you for that job. Furthermore, I am recommending you for full membership in our Executive Ostrich Club. We are having our annual meeting this Saturday down at Jones Beach, where for 24 uninterrupted hours we traditionally get together and put our heads in the sand. It is wonderful not to know what is going on for a whole day and night. To be completely oblivious to the future consequences of the actions which we take today is positively exhilarating."

I hesitate to waste any more of your time by talking about long-range projections, particularly since I always thought that was the *raison d'etre* for the actuarial profession. However, because of some of the statements I have heard at this meeting, I feel obliged to state my opinion that it is absolutely essential that any long-range program like Social Security be financially viable under some set of conditions, even though those conditions may not actually prevail in the future. Too many people are saying that, even

though our projections indicate financial disaster for the future, we should not be concerned since we don't know the precise dimensions of that disaster. Too many people who cannot comprehend the future take the attitude they should not worry about it.

Consider just one other item: 96 percent of the total old-age benefits that are going to be paid under the Social Security program during the next 75 years are going to be paid to people who are now living. Now, even though some of you as actuaries may not be interested in these long-range projections. I think the people who expect to receive these benefits have a vital interest in whether the Social Security program is a financially viable proposition.

Each of you has been furnished a copy of an article entitled "Financial Status of Social Security Program After the Social Security Amendments of 1977" (reprinted from the Social Security Bulletin, March 1978). An examination of Chart 1 and Tables 5 and 6 in that article (reproduced hereafter in slightly different form for convenient reference) will reveal that the Social Security Amendments of 1977 did not solve all of the financial problems of the program. In particular, they postponed resolution of the following two potential problem areas:

- With respect to the Old-Age, Survivors, and Disability Insurance program, the long-range financing problem beginning in the year 2011 when the children of the post-World War II baby boom begin to reach age 65.
- With respect to the Hospital Insurance program, the short-range financing problem caused by the continuing rapid escalation of hospital costs, and the long-range financing problem caused by the aging of the post-World War II generation.

The tax rate on both employers and employees for the OASDI and HI programs combined is scheduled under present law to increase from 6.05 percent in 1978 to 7.65 percent by the year 1990. However, this will not be adequate to provide the benefits which have been promised. The tax rate will have to continue increasing after 1990 to a level of about 8.0 percent by the year 2000 and 12 percent by the year 2025, after which it can remain approximately level.

This is in addition to the cost of the Supplementary Medical Insurance program which is projected to rise from the equivalent of 0.85 percent of taxable payroll in 1977 to about 2.50 percent by 2025, after which it will remain approximately level.

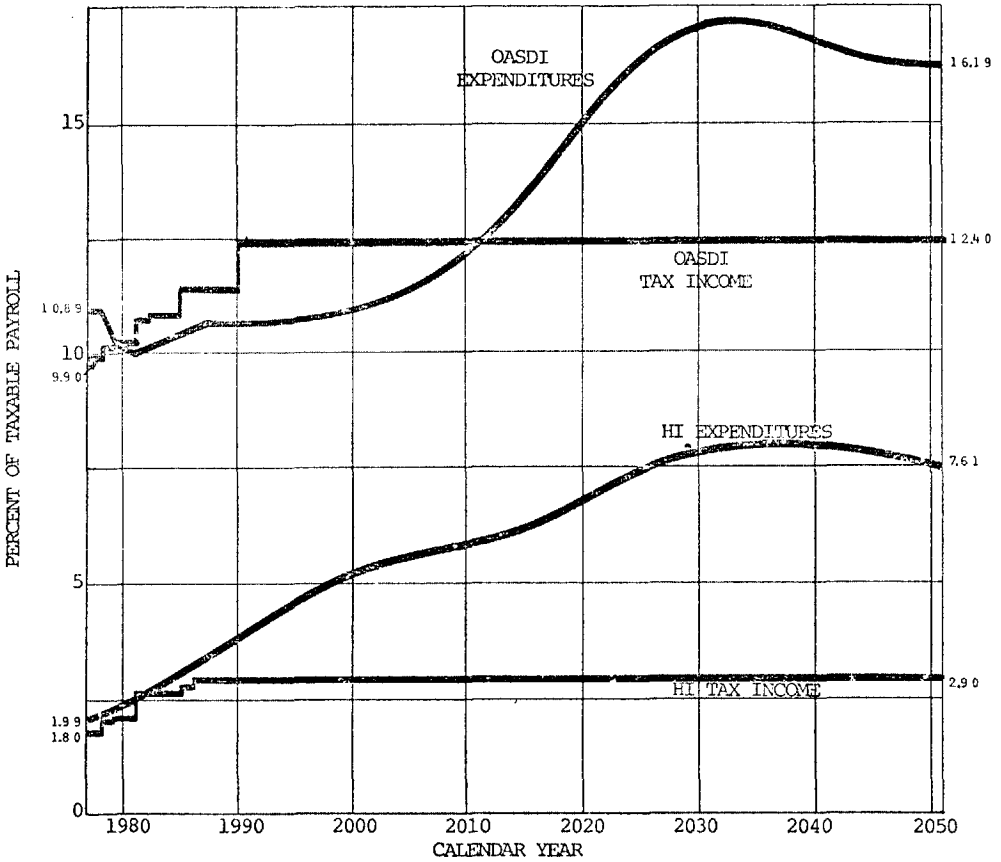
The Supplementary Medical Insurance (SMI) portion of Medicare is an optional program available to most persons age 65 and over and to certain disabled persons. About 95 percent of those eligible for this program have elected to participate.

The cost of SMI benefits was met originally by premiums paid by the participants and approximately matching payments from general revenues; however, at the present time about 70 percent of the total cost is being paid from general revenues because, by law, premiums have not been permitted to rise as rapidly as total costs have risen. The percentage of the total cost paid by general revenues can be expected to increase in the future, probably to about 90 percent by the year 2000 and 96 percent by the middle of the 21st century.

Accordingly, significant tax increases lie ahead if the present Social Security program is to be maintained. Unfortunately, it has been my observation (this is a rather harsh comment which Bob Myers may want to mitigate somewhat) that during the past three years there have been subtle, but persistent attempts by the Congress and by the Administration to minimize the significance of these long-range projected costs and, in some cases, to conceal them. When the costs couldn't be concealed they have been apologized for. Neither concealment nor apology is going to change these high future program costs. The public must be told forthrightly what the Social Security program costs, now and in the future. In addition, the public must be informed of the rationale of the Social Security program, so that there is a clear understanding of who pays the cost, who receives the benefits, the exact role the program is playing in meeting the nation's income maintenance needs, etc. The public will then be in a position to decide whether or not they want a program which will require a tax rate of 12 percent, instead of 6 percent, within our lifetime. If the public reaffirms the present Social Security program, well and good. If the public wants a change, we should set about now to design an alternative program.

OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE AND HOSPITAL INSURANCE PROGRAMS

PROJECTED OASDI AND HI EXPENDITURES
AND LEGISLATED TAX INCOME:1977-2051



ARITHMETIC AVERAGE OF EXPENDITURES, TAX INCOME, AND THEIR
DIFFERENCE (INCOME MINUS EXPENDITURES),
EXPRESSED AS A PERCENTAGE OF TAXABLE PAYROLL

Time Period	OASDI			HI		
	Expendi- tures	Tax Income	Differ- ence	Expendi- tures	Tax Income	Differ- ence
1977-2001	10.60%	11.57%	0.97%	3.60%	2.70%	-0.90%
2002-2026	13.46	12.40	-1.06	6.48	2.90	-3.58
2027-2051	16.69	12.40	-4.29	7.53	2.90	-4.63
1977-2051	13.58	12.12	-1.46	5.87	2.83	-3.04

OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE AND MEDICARE PROGRAMS

PROJECTED EXPENDITURES, TAX INCOME, AND NET DIFFERENCES
EXPRESSED AS A PERCENTAGE OF TAXABLE PAYROLL ^{1/}

Year (1)	Old-Age and Survivors Insurance			Disability Insurance			Medicare Hospital Insurance			Total for OASDI			Medicare Supplementary Medical Ins. Expenditures ^{3/} (14)
	Expend. (2)	Income (3)	Difference ^{2/} (4)	Expend. (5)	Income (6)	Difference ^{2/} (7)	Expend. (8)	Income (9)	Difference ^{2/} (10)	Expend. (11)	Income (12)	Difference ^{2/} (13)	
1977	9.39	8.75	-0.64	1.50	1.15	-0.35	1.99	1.80	-0.19	12.88	11.70	-1.18	0.85
1980	8.63	8.66	0.03	1.48	1.50	0.02	2.22	2.10	-0.12	12.33	12.26	-0.07	0.96
1985	8.79	9.50	0.71	1.66	1.90	0.24	2.98	2.70	-0.28	13.43	14.10	0.67	1.28
1990	8.71	10.20	1.49	1.87	2.20	0.33	3.76	2.90	-0.86	14.34	15.30	0.96	1.64
1995	8.68	10.20	1.52	2.07	2.20	0.13	4.52	2.90	-1.62	15.27	15.30	0.03	1.90
2000	8.63	10.20	1.57	2.34	2.20	-0.14	5.27	2.90	-2.37	16.24	15.30	-0.94	2.00
2025	13.49	10.20	-3.29	2.91	2.20	-0.71	7.44 ^{4/}	2.90	-4.54	23.84	15.30	-8.54	2.63
2050	13.35	10.20	-3.15	2.82	2.20	-0.62	7.61 ^{4/}	2.90	-4.71	23.78	15.30	-8.48	2.52

^{1/} The effective taxable payroll is slightly different for OASDI and HI because of the tax treatment of self-employed persons; however, it does not materially affect the comparisons. In 1977, taxable payroll represented about 85 percent of total earnings in covered employment; in 1981 and later the corresponding percentage will be approximately 91 percent.

^{2/} Expressed as income minus expenditures. Negative figures indicate deficits.

^{3/} Expenditures are approximately equal to total income from premiums and general revenue for the Medicare-SMI program. Although the Medicare-SMI program is not financed by payroll taxes, its cost is shown for comparison as a percentage of payroll which is taxable for HI purposes. Figures after 1977 are based upon unpublished estimates.

^{4/} Based upon unpublished estimates. For the purpose of this comparison, it was assumed that after the year 2000 medical care unit cost increases would be equal to average wage increases in covered employment.

MR. ROBERT J. MYERS: If there is any doubt in anybody's mind about what I think about the desirability and necessity for long-range cost estimates for OASDI, and also their significance, I am completely in agreement with Haeworth on what he said in the beginning of his talk. As to his last remark about the Executive Branch and the Congress trying to play down the seriousness of the long-range cost situation, I would only partially agree. I think that the entire blame has been on the part of the Executive Branch and not on the part of the Congress. I think that it is the Executive Branch's responsibility to point this situation out more clearly and to do something about it. Also to blame is one group that Haeworth did not mention, what you might call the program executives outside of the government. These are people who are continually advocating what they call improvements or expansions, depending upon how you want to classify it. Of course, they are very much concerned about showing that the program does not have any financial difficulty, or else as to these financial problems that are apt to come up in the future they will say not to worry about them.

It is likely that, when the Program Committee developed the agenda for this session, it was believed that, in the Social Security field, the dust would have settled after the long and somewhat hectic legislative developments that led to the enactment of the 1977 Amendments last December 20. Unfortunately, in my opinion, this has not been the case, because of an unusual turn of events.

In balance -- and especially as compared with what I had expected to come out of the end of the legislative tunnel after the initial proposals of the Carter Administration -- I believe that these amendments were a great step forward in rationalizing the benefit structure and in substantially restoring the solvency of the OASDI system over the long-range. There were, however, two major points on which I would have preferred other action to have been taken.

Undesirable Features of the 1977 Amendments

First, the ultimate tax rates (beginning about three decades from now) should have been somewhat higher, so as to result in full actuarial balance being shown, rather than leaving a long-range deficit averaging 1.46% of taxable payroll. It is significant to note that the Senate version of the legislation would have accomplished the desirable result of long-range actuarial balance.

Second, it was undesirable that the maximum taxable earnings base was increased by the three ad hoc jumps in 1979-81. Particularly, \$1,800 of the increase in 1981 was unjustifiable, because it arose solely as a result of the unrelated amendment by Congressman Fisher of eliminating compulsory coverage of governmental employees. Certainly, this was an illogical method of financing such a change. Instead of these increases in the earnings base, I preferred the approach taken by Senator Curtis of increasing slightly the tax rates, as has been done so often in the past. Unfortunately, this amendment lost by a margin of only one vote on the Senate floor.

Desirable Feature of the 1977 Amendments

On the plus side, I hasten to point out what I believe to be the generally excellent decoupling procedures adopted. Replacement rates were stabilized, which I believe to be a necessary feature of any well-planned benefit system.

And this was done at a level that averages about 7% below what would have prevailed in 1979 under the previous law. Such reduction is justified because of the over-expansion of the benefit level in the recent past--due both to the operation of the faulty benefit computation mechanism and to excessive ad hoc increases that were made in 1969-72. Although it is widely stated that the reduction in the replacement rates over the long-range due to the 1977 Amendments is 5%, actually it is 5½% for deaths and disabilities before age 62 and for retirements at age 62, but as much as 12% for retirements at age 65 and over, accordingly averaging about 7%.

It is important to note the little known fact that these over-expansions of the benefit level had been partially counter-balanced by reductions (of an unplanned nature) in both the ad hoc benefit increase in 1974 resulting from the 1973 Amendments and the first automatic adjustment of benefits (for June 1975).

The decoupling procedure effectuated by the 1977 Amendments also considerably ameliorated the long-existing anomaly with regard to disability and survivor benefits with respect to young workers--namely, relatively high, even excessive, benefits relative to final take-home pay. And, in fact, the benefits for such individuals illogically greatly exceeded those for older workers with similar pay levels and family situations, even though the latter had been making Social Security contributions for a much longer period. Under current law, as it will affect such cases occurring after 1978, there will be a much more reasonable and consistent benefit level.

The 1977 Amendments overall were praiseworthy in providing sufficient financing for the OASDI system over the short run and likely for the next three decades. As indicated previously, in my view, it would have been preferable to accomplish this result solely by increases in the tax rates, rather than partially by this procedure and partially by large ad hoc increases in the maximum taxable earnings base. But, in any event, it was very encouraging that both the House and the Senate strongly and vocally rejected the proposal of the Carter Administration to inject general revenues into the financing of OASDI. And, at the same time, logical reasons for such actions were expressed by prominent congressional leaders.

A Minor Benefit Anomaly in the 1977 Amendments

There was, however, one minor point in connection with the decoupling procedure adopted in the 1977 Amendments (which may, perhaps, seem "major" to the closed group affected) where I believe--and have testified--that a different approach should have been taken. Under the law as enacted, there is a very sharp breaking point in the benefit amounts, especially for retirement at age 65 or over, as between persons who attain age 62 before 1979 and those who attain age 62 in 1979 or shortly thereafter.

The former group receives much larger benefits, both relatively, and even to some extent, in absolute dollar terms. For example, let us consider an individual retiring at age 65 who has always had maximum earnings in the past and who is currently at the \$17,700 level and will have wage increases in the future paralleling the national average. Such person will have a replacement rate of about 34% if in the cohorts that attain age 65 in any of the years 1979-81, as against a person in the cohorts attaining age 65 in 1982 and the next few years thereafter having a replacement rate of only about 30½%.

This sharp "precipice" could have been avoided--and should have been avoided--by having a more gradual phase-down. What caused the difficulty--and what could be done to remedy it--is a very simple matter. The alternative transitional benefit computation involving the use of the old-law benefit formula frozen in its form as of the end of 1978 (until the year of attainment of age 62) can, under existing law, use only earnings before the year of attainment of age 62. This resulted from the recommendations of the Carter Administration and was done in order to lessen administrative work by phasing out this transitional benefit computation method quite rapidly. It is desirable to have administrative simplicity, although not at the expense of creating benefit anomalies. The solution, in practice, could be legislated at any time before 1980 without creating administrative problems. What should be done is to permit earnings at and after age 62 to be used in this alternative benefit computation method.

The Tax-Increase Panic

At present, there is an undue and misleading cry of crisis--even panic--about the financial effects of the 1977 Amendments. One frequently hears that this legislation increases taxes over the next decade by \$227 billion, a stupendous figure. Also, it is often brought out that individuals' taxes will be tripled as between 1977 and 1987. Both figures are correct under certain circumstances. However, not all of the facts are presented. Accordingly, quite erroneous conclusions are drawn.

The dollars referred to for future years are not today's dollars, but rather those after allowance is made for assumed inflation. The \$227 billion of additional taxes over the next decade is actually only about 14% higher than would have been levied under previous law.

The stated threefold increase in taxes for individuals applies only to those who currently earn more than about \$25,000 per year. Even then, the taxes for such an individual would--in large part because of inflation--have been doubled under previous law. Accordingly, the correct increase for this group is a 50% one, not 200%. This is, of course, a very significant increase, which was caused primarily by the undesirable sharp ad hoc increases in the taxable earnings base. Workers currently at the \$17,700 level or lower will, on the whole, have their taxes for 1978-87 increased by only 6.5% under present law as compared with previous law.

Proposed "Solutions" to Relieve the Burden of the Tax Increases

At the final stages of the enactment of the 1977 Amendments, many Republican members of Congress made a point about the greatly increased taxes thereunder in the next few years. This was picked up with vim and vigor by the public media--and not what I believe to be the more important facts that the benefit structure was rationalized and that the short-range financing problems had been completely solved and the long-range ones considerably ameliorated.

As a result, in the last few months, there has been a spate of proposals to "lessen the financial burden of the Social Security taxes by substituting general revenues in the financing of OASDI". These include such proposals as:

- (1) Financing 33 1/3% of OASDI and HI cost from general revenues and reducing payroll tax rates correspondingly (Congressman Burke, D. and Senator Hathaway, D.).

- (2) Financing 50% of HI cost from general revenues, eliminating the 1979-81 ad hoc increases in the earnings base, and reducing the combined OASDI-HI tax schedule to take into account the first two changes (Congressman Conable, R.).
- (3) Financing 100% of DI and HI cost from general revenues and reducing payroll tax rates correspondingly, increasing the maximum taxable earnings base on workers and employers to \$100,000 in 1979, with automatic adjustments thereafter; and revised schedule of future tax rates, such that total income to OASDI is somewhat lower until 1990, but somewhat higher thereafter (Congressman Mikva, D. and Senator Nelson, D.).
- (4) Having a moratorium for 1979-81 as to the increases in the earnings base and the tax rates caused by the 1977 Amendments (i.e., restore the situation to what it would have been under previous law) and have general revenues payments make up the difference as between what the tax income would be under the 1977 Amendments as against what it would be under the "rolled-back" situation (Senator Nelson).
- (5) Providing a tax credit against individual income taxes of 10% of the OASDI and HI taxes paid--i.e., the net effect is the same as reducing OASDI and HI taxes by 10% and substituting general revenues therefor, except (and importantly) the appearance is different, and the full "burden" of the OASDI and HI taxes is still "visible" (Senator Danforth, R.).
- (6) Same as proposal (5), except a 20% tax credit (Senator Dole, R.).
- (7) Same as proposal (5), except a 15% tax credit, but not in excess of the individual's income-tax liability (Senator Eagleton, D.).
- (8) Same as proposal (5), except a 10% tax credit, but for employers and self-employed persons rather than for employees and self-employed persons (Senator Haskell, D.).
- (9) Providing a tax credit against income tax for employers, employees, and self-employed persons of the difference between the actual OASDHI tax paid and that which would have been paid at the 1977 tax rates (Senator Domenici, R.).
- (10) Freeze the OASDHI tax rates at the rates prevailing in 1977 and make up the difference between what the tax receipts would be under the present law rate schedule from general revenues (Senator Hatfield of Montana, D.).
- (11) Financing partially from some tax other than payroll taxes, but specifically earmarked therefor (Representative Ullman, D.). Some persons have suggested that this be done by using the receipts from the proposed "crude oil equalization tax" in the pending energy bill (such tax having been advocated by the Carter Administration and approved by the House, but rejected by the Senate); one difficulty with this approach is that such a proposed tax is to be applicable for only a temporary period of 3-5 years.

Desirability of Government Subsidies to OASDI and HI

Financing any part of OASDHI from general revenues (i.e., a government subsidy) at the same time that there is also financing through payroll taxes is extremely undesirable. The presence of a government subsidy would very likely change the general character of the system for the worse. It would weaken the concept that the benefits involve an insurance right and have been "earned" by the beneficiary. Introducing even a small amount of government subsidy on an ongoing basis (or even supposedly, on a "temporary" basis) would probably loosen cost controls and be like an alcoholic taking "just one little drink."

Another significant factor about such a government subsidy, which has been so well brought out by so many, is that there just is not any money in the General Treasury currently.

The primary objection to a government subsidy is that such a procedure is basically misleading and deceptive. Many economically unsophisticated people believe that, under such circumstances, they will be getting something for nothing and that somebody else will be paying for their benefits. Some might even be so naive as to believe that the General Treasury has "money of its own" which can be used for these purposes.

The following astounding, naive statements appeared in the Associated Press story on April 5, 1978: (a) a suggestion for a Social Security tax rollback "would save some taxpayers as much as \$292 next year" (with no consideration of the indirect cost of the replacing general revenues!) and (b) a proposal for general revenues to meet one-third of the cost of OASDHI "would cost the government more than \$30 billion" (query—does the "government" have money of its own?).

Any informed person knows that financing of OASDI and HI from general revenues will result in tax burdens of the same magnitudes on the taxpayers of the nation, who are essentially the same people as those covered by OASDI and HI. If new taxes are levied to obtain the necessary general revenues to provide the government subsidies to OASDI and HI, they will very likely, in the long run, be paid by virtually the same people who are subject to the payroll taxes--and probably to about the same extent individually. The initial incidence of any new tax may appear to fall less heavily on some groups than others. Over the long run, however, such incidence will undoubtedly change, and it is really impossible to determine what the real incidence is, has been, or will be.

Economists who make extensive theoretical studies with econometric models and computer runs are living in a dream world if they believe that they can precisely determine the incidence or regressivity of any tax.

If new taxes are not levied to meet the general revenues needed for such a government subsidy, the result would be printing-press money. This, in turn, would cause additional inflation. Thus, in the end, the cost would really be borne through higher prices by the entire population, falling largely on the same covered workers who think that they will have higher net incomes because of lower payroll taxes.

It is frequently pointed out that many workers pay more in Social Security taxes than in federal income taxes. This argument is really like comparing

apples and baseballs. Social Security taxes are individuals' expenditures for a type of personal service and, therefore, quite different from other taxes. I believe that people should have their personal dignity retained by paying the same rate for personal expenditures as do other people, and they should meet the full cost thereof, rather than a caste system of "bargain" rates being established. If there is a problem of insufficient income for those with low earnings, it should be solved directly--possibly, through the income tax route, such as the earned income credit for families with children or through some other income program (even including recognition of Social Security taxes as deductions or credits in the computation of income tax liability) rather than indirectly by reducing the generally-applicable cost for a particular type of expenditure, such as Social Security contributions.

One proposal would finance DI and HI completely from general revenues, leaving OASI financed completely from payroll taxes. It is argued that DI and HI are not truly "insurance", but rather are "welfare", and thus should be financed from general revenues.

I believe that OASI, HI, and DI are all truly "insurance" in the broad sense of the term of a pooling of risks in a program that is governmentally administered and has definite provisions for payment of benefits as a right and definite financing therefor.

Those who assert that HI is not "insurance" do so on the grounds that the benefits are not earnings-related, as are those in OASDI. To my mind, this is not a sufficiently distinguishing characteristic, because HI still has the broad sharing of the risks. Furthermore, OASDI does not by any means have a strictly proportionate relationship between benefits and the previous earnings level.

DI has earnings-related benefits, and so it should not be called "welfare" instead of "insurance" if OASI is considered to be "insurance". Actually, more of an "insurance" element is contained in the disability benefits than in the old-age benefits, because there is only a relatively small probability that an insured worker will receive the former, whereas there is a very high probability that most workers, particularly older ones, will receive retirement benefits.

Possibility of Government Subsidy to Social Security Program

The "least worst" approach to financing the Social Security program partially through direct general revenues, in my opinion, would be to fund HI completely from general revenues. As an inseparable part of such a proposal, the general revenues should be obtained completely by a highly visible, special earmarked tax, such as a fixed percentage of adjusted gross income for income tax purposes or a fixed percentage of the actual income tax payable.

It has been suggested that Congress should re-examine the financing procedures adopted in the 1977 Amendments, and in the meanwhile, the tax rates and taxable earnings bases for 1979-81 should revert to what was contained in the law previously. Under these circumstances, the financing should be provided by loans from the General Treasury, repayable with interest, representing the difference between the tax receipts on the two bases, rather than outright government grants or subsidies.

MR DONALD SEGAL: What is the cost effect of the new law that prohibits mandatory retirement before the age of 70?

MR. MILTON P. GLANZ: The cost effect on the OASDI program is a reduction of .08% of taxable payroll.

MR. E.J. MOORHEAD: I have two questions. One is for Haeworth Robertson, and the other is for Bob Myers.

For Haeworth Robertson, I would like to ask whether the public really knows enough about Social Security.

MR. ROBERTSON: No. The public needs to know how costs will rise in the future. Especially, the public does not know enough about the benefits of the Social Security program. The public needs to know the rationale underlying the Social Security program, and also what it actually does do.

MR. MOORHEAD: For Bob Myers, I would like to know whether, when you say that Congress knows what it is doing, you refer to the entire Congress or to the Social Security specialists.

MR. MYERS: I think that it is appropriate to refer only to the Social Security specialists in the Congress, because the rest of the Congress does defer to their judgment.

MR. THOMAS KABELE: Was any consideration given to allow phase I (mutual) life insurance companies to deduct from their income tax all of their Social Security taxes, just like other corporations? I believe that tax-exempt foundation did request special considerations.

MR. MYERS: I do not know about this aspect of the subject, nor do any of the other panel members seem to know.

MR. JOHN ROWELL: If we consider the historical tax increase at the maximum taxable level we find that: (1) for 1947-57, the increase averaged 10.8% per year; (2) for 1957-67, the increase averaged 13.2% per year; (3) for 1967-77, it was 12.85% per year; and for 1977-87, it is scheduled to average 12.2%.

So, the maximum taxable increase scheduled in the new law is not unusual.