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SOCIAL SECURITY

*Moderator: ROBERT F. LINK. Panelists: A. HAEWORTH ROBERTSON, GEOFFREY N. CALVERT, LAWRENCE THOMPSON**

Though OASDI was thoroughly updated by the 1977 Amendments, many serious questions are still under active discussion. This panel will consider possibilities for future changes in such areas as:

1. Financing
2. Retirement age
3. Benefit design
4. Treatment of women
5. Retirement test.

Also the paper "An Alternative Approach to Universal Social Security Coverage" by Robert J. Myers will be discussed.

MR. ROBERT F. LINK: Your program indicates that Bob Myer's paper "An Alternative Approach to Universal Social Security Coverage" is going to be discussed here, and we'll do that first. We're honored to have Bob here to present his paper.

MR. ROBERT J. MYERS: I would like to discuss very briefly the situation regarding universal Social Security coverage: what the problem is, what I think the best solution is, what alternative solutions there are and a topic that is not mentioned in my paper - - the problem of what should be done about Hospital Insurance (HI) benefits when there is not universal coverage.

Over the years all students of Social Security, whether they be of the expansionist philosophy, the moderate philosophy or even the conservative philosophy, have said that everybody in the paid workforce in the country should be in the Social Security system. In practice almost all employed workers are, except for two large groups: government employees and employees of charitable, educational and religious nonprofit organizations. About 10% of the federal civilian employees are covered by Social Security (namely, those with temporary appointments). In the state and local government area, about 74% are covered by Social Security. In the nonprofit area, about 80-85% are covered; most of the remainder are part-time workers.

Now what is the problem if there is not universal coverage? There are three problem areas. First, persons who are not covered under Social Security

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during most of their working lifetime have an opportunity to obtain windfall benefits at the expense of the rest of the covered population. Second, short-service workers in noncovered employment, by not being covered at certain periods, might lose all of their Social Security benefit protection or else have their benefits diminished by the gaps in coverage. Third, government employees - - generally being somewhat higher paid than the average worker in the country - - by not being covered are not bearing their share of the social cost of the program.

The best solution to the problem of not having universal coverage is of course to have coverage extended to all groups not now covered by appropriate legislation. This is the solution in theory. In practice however, there are great difficulties. One difficulty is the question of the constitutionality of the Federal Government compulsorily covering state and local employees (because of the levying of the tax on the employer). This probably could be solved in one way or another. The real difficulty is political. The groups not covered do not want to be covered, largely because they think they can get Social Security benefits in some other way - - through part-time employment or working after early retirement. They allege that the Social Security benefits so derived are theirs because they will have "bought and paid for" them, which of course is not true.

My paper is written under the presumption that universal coverage cannot be obtained directly\and it suggests two alternative solutions. Both of these solutions are directed only to eliminating the windfall-benefits problem. One solution is to compute a Social Security benefit based on the individual's total employment (covered and noncovered) during his or her lifetime and subtract from that the Social Security benefit based only on noncovered employment. In other words the benefit would be paid based only on the residual part coming from the covered employment that the individual had during a small part of his or her working lifetime. As you can see from the tables in the paper, this would very sharply reduce benefits. In my view it is a better approach than the other proposed solution. However it is less feasible, both politically and practically. It would be somewhat difficult to explain to people. Also the reductions are so severe that the protests of those whom it would affect would likely be too strong to allow passage of the necessary legislation.

The other solution - - what might be called the pro-rata approach - - is practical, more easily understood and more difficult for anybody to oppose. Under this solution a Social Security benefit based on total lifetime earnings in both covered and noncovered employment would be computed, but only that pro-rata portion that the wages in covered employment (after indexing) represent of the total wages both in covered and noncovered employment (again after indexing) would be paid. This in essence would take away the heavy weighting that is now available to people who have only a small part of their career in covered employment. Another feature of this solution - - not a necessary one, although very desirable - - is that the calculation would only be based on noncovered employment after a certain effective date in the future so that there would not be a very adverse effect immediately. Thus the change would phase in gradually and would not take away any "accrued rights" to windfall benefits that individuals may have earned to date.

Finally what about the windfall benefits that people receive for Hospital Insurance? (This is not mentioned in my paper.) Benefits under the HI program are uniform. If a person qualifies for them, the same benefit is paid no matter whether that person just barely qualified with minimum covered earnings or whether coverage had been for a lifetime at maximum earnings. Here the problem is somewhat difficult to solve, although in many instances there really is not a problem. For federal employees for instance, obtaining coverage under HI is not all that advantageous because there already is a very comprehensive health benefits program for federal employees that continues into retirement at exactly the same level as in active service. Thus qualifying for HI is not that much of a financial gain for these employees.

MR. ALAN E. SONNANSTINE: I was curious if you had had a chance to do some comparisons of the benefit formulas with dynamic inflation assumptions in the future. I noticed that your calculations were all done assuming constant pay from now until retirement. Does it change the results very much if you do assume some constant rate of inflation in the future?

MR. MYERS: I thought that - - at least as far as the initial benefits were concerned - - it did not make any difference whether or not I assumed inflation because both the results in the numerator and the denominator seemed to come out the same and thus cancel each other out.

MR. SONNANSTINE: I was surprised that there was such a dramatic change in the benefits using your first method. I wondered if there was some unusual feature in the benefit formula itself to account for this.

MR. MYERS: I believe that this result arises only because of the heavy weighting of the benefit formula. Frankly I was very much surprised. I thought that my first method was the better one but, when I saw how it slashed the benefit amounts, I thought that it would not "sell". So then I developed the second method, which seemed to produce somewhat more reasonable results.

MR. LINK: The second part of our program today is going to be a panel discussion rather than a series of speeches. First there will be a presentation of the main features of the Advisory Council's report. Then there will be questions and comment by the panelists with opportunities for questions and comment from the floor.

What is the situation now?

Social Security is supposed to have just been fixed up by the monumental 1977 Amendments. Is everybody satisfied? No. There is concern about the impending insolvency of the system, short term. There is concern about the impending insolvency of the system, long term. The taxes are perceived to be almost intolerable. Many people want to go for a quick fix from general revenues. There are problems about the treatment of women, problems about the retirement test, problems about universal coverage.

Various people are suggesting all sorts of solutions. Some of these will be brought out in Larry's discussion. Other major approaches are things like double-decker systems or proposals to advance-fund Social Security in lieu of the present transfer payment system. Social Security ought to be larger. It ought to be smaller. It ought to stay as it is.

You are here today presumably because you are interested in Social Security; perhaps because this is a time of critical concern about Social Security and you may have some hope of contribution to solutions or improvements. If the latter is the case, you will be interested in some commentary from Martha Derthick of the Brookings Institution. It appears in her excellent new book Policymaking for Social Security. I recommend this book to anyone who wants to understand how things actually happen in this area. Reading from page 167:

> How much of a threat expert criticism posed, and what kind of action it therefore evoked from program executives, depended very much on whether the criticism was linked with a source of political power. Purely private debate was one thing; what was said at the annual meetings of the actuarial society did not matter much as long as it was only speech in an academic setting. But expert critics of the program - - those who were economists, mainly-- had a way of turning up in public or quasi-public offices, from which their criticism could more easily enter into the stream of actuarial discussion over public policy, creating unwelcome crosscurrents.

It takes more than desire and expertise to make a difference.

Larry Thompson will now present the status of the current Advisory Council's work.

(EDITORIAL NOTE: Most of the tape-recording of this session was inadvertently lost or destroyed in Bal Harbour. What follows is a reconstruction.)

MR. LAWRENCE H. THOMPSON: Thank you. This morning I will summarize the recommendations that the 1979 Advisory Council will be making in its final report.

The Advisory Council spent more of its time debating the treatment of women under Social Security than on any other issue. It recommended the adoption of two changes immediately:

1. When one spouse of a marriage dies, the surviving spouse will inherit the earnings credits of the deceased spouse for the years in which they were married. Those will be added to the earnings of the surviving spouse, filling his or her earnings record up to the maximum taxable each year. When they reach age 62, surviving spouses would become eligible for retired worker benefits based on the combination of their own and their inherited earnings, instead of the aged widow or widower benefit now paid.

2. When a marriage has lasted for ten years and ends in divorce, the earnings credits accumulated during the years of the marriage will be split equally for the purpose of computing retirement benefits only.

The second change is a very limited form of earnings sharing that only deals with those people who now receive aged divorced spouses' or aged surviving divorced spouses' benefits. In combination with the inheritance of earnings credits, the earnings sharing upon divorce would replace benefits now payable to aged people based on a divorced spouse's earnings.

These recommendations address several of the important concerns of women's groups: a somewhat more adequate benefit for widows, an equalization of the survivor benefits between one-earner and two-earner couples, and better treatment of the lower earner - - usually the woman - - in a divorce. They do not address one of the major concerns, the differential in retirement benefits between a one-earner and a two-earner couple while both parties are still alive.

The Council did recommend that some form of earnings sharing is the most promising approach to this remaining issue, as well as the other important issues concerning women. However it was unable to come up with a plan satisfactory to everyone and could not recommend the adoption of a specific plan. It did encourage general debate and further development of the earnings-sharing approach.

The Council made a number of recommendations in the area of disability. It recommended reducing the waiting period before benefits are payable from five months to three months. It endorsed the series of work incentive proposals which are in the bill that passed the House and is now pending before the Senate Finance Committee. And it endorsed a cap on benefits much less stringent than the one in the bill now before the Congress. The Council recommended a cap that was set at 90% of the highest five consecutive wage-indexed years of earnings.

The Council endorsed the extension of mandatory Social Security coverage to those Federal, State and local government employees and those private non-profit employees not now covered. It did not recommend a specific way of implementing universal coverage but indicated that the most promising way would be to cover all persons newly hired by these organizations. That means that universal coverage will phase in only slowly.

The Council also recommended the adoption of an earnings coordination or offset plan such as either of the two that Mr. Myers was just describing here a few moments ago. It recommended that no State or local government be allowed to terminate participation in Social Security. It also recommended that Congress close the loophole that has become relatively famous in the last few months where the employer pays the employee's share of the payroll tax.

The Council will make a series of recommendations having to do with the benefit structure, the most important of which is a new benefit formula. The new formula introduces a significant change for three types of workers. The first is a worker (probably a theoretical worker) who has worked every year under Social Security for at least 30 or 35 years, earning on the average about the level of the Federal minimum wage for 2,000 hours a year. Under the alternative formula being recommended, such a worker would receive at age 65 a benefit equal to the poverty line for a single individual.

The second kind of person who would gain under the new benefit formula would be a young person now entering the labor force, or one now age 30 or 40, who is consistently earning at the maximum. At present, benefits are computed with a three-bracket formula that starts off with 90% of the first $180 of average indexed earnings and then provides for 32% of the next $905 and finally bends around to provide 15% of earnings in excess of $1,085. The Council will recommend instead the adoption of a two-bracket formula which begins with 61% of the first $442 (which is about the level of the minimum wage) and then provides benefits equal to 27% of all earnings in excess of $442.

Today's younger workers are going to be taxed on higher amounts of earnings than was the case for many people now approaching retirement age because the relative level of the earnings base has been increased recently. The Council believed that those young workers should be able to expect marginal increments in their future benefits resulting from additional earnings to be such that the discounted present value of the increase in future benefits always exceeds the discounted present value of the employee's share of the additional tax paid on additional earnings. The new formula achieves this objective.

The third group affected by the change are people at the very bottom of the present benefit formula. By and large these people are in-and-outers who have not worked consistently under Social Security. Under the alternative benefit formula recommended by the Advisory Council, they would get less than they are presently getting.

The Council also recommended twice yearly cost-of-living adjustments; an increase in the lump-sum death benefit; adjusting the retirement test by bringing the exempt amount for those under age 65 up to the level of the exempt amount for those age 65 and over; and entering one-half of Social Security benefits received into adjusted gross income for Federal income tax purposes.

Now let me say a few words on the Council's financing recommendations which may be of more interest to this group than many of the others. First of all the Council explicitly endorsed the policy of current-cost financing, explicitly rejecting the notion of accumulating a large reserve. It then struggled with the question of the forecasting periods.

Social Security revenues and expenditures are now projected for 75 years in the future. Some members of the Council felt that, for a variety of reasons, 75-year estimates were misleading. Some members just thought that it was impossible to project expenditures that far into the future with any precision and that we were only kidding ourselves in continuing to do so. Others - - perhaps more Machiavellian - - were concerned about the fact that the projections now show a sharp increase in costs between 50 and 75 years into the future. They argued that there is not sufficient knowledge to allow us to make such projections with any real confidence and that the results now being disseminated serve only to undercut public confidence in the program. Still others defended the present practice arguing that, though necessarily imprecise, long-range projections did alert us to emerging trends and provided a valuable early warning system. The Council finally decided to recommend the continuation of 75-year projections, but to urge also that Social Security policy be set primarily on the basis of projections of effects during the first 25 years. (My understanding is that we are fairly unique in the United States in that we have always made such long-range projections. The Europeans have tended to project expenditures only five to ten years into the future, but some are now beginning to look at longer range projections.)

Near the end of its deliberations, the Advisory Council coalesced around a new financing plan for Social Security, or more accurately, a new financing plan for the Hospital Insurance program. The plan involves financing the HI program entirely from the general fund. This proposal is similar to a recommendation of the previous (1975) Advisory Council, but differs in two important ways. First, the previous Council recommended introducing gradually increasing amounts of general revenues into the HI program until it was financed entirely by the general fund. The rate at which general revenues were introduced would be determined by future financing needs. The objective would be to hold the total OASDHI payroll tax rate constant. In contrast the current Council would introduce full general revenue financing of HI immediately. Another important feature in the plan endorsed by the present Advisory Council is that one-half of the general fund revenues required to finance HI would come from an earmarked portion of the personal income tax. Thus every income tax payer would know that some fraction of the payment that he was making was being used to finance Hospital Insurance, and each would therefore expect to receive benefits from the HI program as an earned right at the appropriate time. The Council recommended that the other half of the needed HI revenues come from the corporate income tax. It is recommended that a part of the payroll tax rate now scheduled for the HI program be shifted to support the programs paying cash benefits and that the balance of the HI payroll tax be repealed.

As a part of its financing plan, the Council recommended that the ad hoc increase in the earnings base now scheduled for next year and for 1981 not go into effect. For the longer term it also recommended that a tax rate increase be scheduled in the law for the year 2005 sufficient to produce a 75-year actuarial balance in the income-outgo calculations.

Finally, the Council recommended combining the Disability Insurance and the Old-Age and Survivors Insurance trust funds into one fund, and taking two additional steps designed to insulate Social Security from temporary fluctuations in the level of economic activity. One step was the endorsement of the proposal made by the Administration in 1977 for counter-cyclical general revenue payments; the second was an endorsement of the provision that passed the House in 1977 but was dropped in conference, allowing the Social Security trust funds to borrow from the general fund if their reserves fall below a specified fraction of expenditures.

MR. A. HAEWORTH ROBERTSON: I was disappointed to learn from today's summary report on the Advisory Council's activities that they did not devote more attention to the long-range financial implications of Social Security.

Our knowledge of the future is limited, to be sure. But it is not as limited as many people assume. Consider the following:

> Eighty-five percent of the people who are going to receive old-age retirement benefits at any time during the next 75 years are

alive today.

These people will receive 96 percent of the total old-age retirement benefits which are paid during the next 75 years.

Of the total Social Security taxes which will be paid during the next 50 years, 81 percent will be paid by people who are now alive. For the first 25 years the figure is 99 percent.

Thus while many of the projection factors are subject to substantial variation, the basic numbers of people who will be tomorrow's workers and beneficiaries can be determined today with reasonable certainty. Long-range projections of future income and outgo expressed in dollar amounts cannot be made with enough certainty to be of value; however, when expressed as a percentage of payroll, future projections become reliable enough to be of value in long-term planning.

We must keep in mind that the purpose of long-range projections is not to predict the future with certainty (no one, obviously, can do that) but rather to indicate how the Social Security program would operate in the future under a variety of economic and demographic conditions, any of which could reasonably be expected to occur. Such projections provide a valuable test of the reasonableness and long-range viability of the Social Security provisions that we enact today.

Each year the Board of Trustees of the Social Security program makes a report to the Congress on the financial status of the program. Unfortunately the Board of Trustees has not been consistent in assessing our nation's ability to fulfill the promises we have made under the various parts of Social Security. Specifically, consider the following:

- Old-Age, Survivors and Disability Insurance Programs

  Projections are made for 75 years; however, there is steady pressure from the "head-in-the-sand" devotees (both inside and outside the government) to reduce this to as short a period as 25 years, and thus ignore the consequences of the inevitable transition from the present youthful population to a future older population.

- Medicare-Hospital Insurance Program

  Projections are made for only 25 years. Hospital Insurance benefits are paid principally for persons aged 65 and over; thus Hospital Insurance benefits may be viewed as a form of retirement benefit. Accordingly it is just as important that 75-year projections be made for these benefits as it is for the old-age benefits.

- Medicare-Supplementary Medical Insurance Program

  Projections are made for only 3 years. These benefits are paid for substantially the same persons who receive Hospital Insurance benefits and thus are just another form of retirement benefit; hence, it is as important that 75-year projections be made for these benefits as it is for the cash old-age benefits and the Hospital Insurance benefits.

Any report that the SMI program is in "sound financial health" is practically meaningless since projections are made for only 3 years.

The actuaries at the Social Security Administration are capable of making long-range projections for the Hospital Insurance and Supplementary Medical Insurance programs, just as they do for the Old-Age, Survivors and Disability Insurance program. They have in fact made such projections several times in recent years. According to the most recent projections based upon the "intermediate" assumptions used in the Annual Trustees' Reports, the expenditures for benefits and administrative costs under the OASDI and HI programs combined will rise from 12.39 percent of taxable payroll in 1979 to approximately 16 percent in the year 2000 and 23 percent by the year 2025, that is, within the working lifetime of today's new entrant into the labor force. Although official projections have not been made, it seems likely that under the "optimistic" set of assumptions used by the Trustees these expenditures would rise to about 18 percent of taxable payroll by the year 2025, while under the "pessimistic" set of assumptions they would rise to some 32 percent of taxable payroll by the year 2025. By the year 2050, these expenditures would be 24 percent under the intermediate set of assumptions and as low as 16 percent under the optimistic assumptions and as high as 45 percent under the pessimistic assumptions.

Long-range costs of the Supplementary Medical Insurance program are usually ignored, probably because SMI is not financed by payroll taxes as is the rest of Social Security. 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 as much as 90 percent by the year 2000 and 96 per cent by the middle of the 21st century.

Although the SMI program is not financed by payroll taxes, its costs for comparative purposes can be computed as a percentage of the payroll which is subject to the Hospital Insurance payroll tax. On this basis expenditures under the SMI program are projected to increase from the equivalent of 0.90 percent of taxable payroll in 1979 to 2.35 percent in the year 2025 (based upon the intermediate assumptions used by the Trustees). Under more optimistic or pessimistic assumptions, expenditures by the year 2025 would probably be in the range of about 2 to 3 percent of taxable payroll.

It seems clear that we should do a better job of recognizing the cost implications of the long-term promises we have made under our Social Security program. The long-range projections for all segments of the Social Security program are available or can be made available by the Social Security Administration and the Health Care Financing Administration.

The purpose of the long-range cost estimates made by an actuary is not to scare people or to cause unrest about the future viability of Social Security. The purpose is to provide the information necessary to ensure that we do not make promises we cannot keep. The purpose is to make certain that Social Security is a program of <u>fulfilled promises</u>, not a program of broken promises.

MR. GEOFFREY N. CALVERT: I would like to add a couple of further clarifications in connection with women's benefits and one or two other things. Between 1950 and 1978 the number of women working increased from 17.8 to 40.9 million. The proportion of women working increased from 34% to 49%. The proportion of married women living with their husbands but going to work increased from 23.8% to 47.6%. The ratio of working men to working women decreased from 2.5 to 1.4, that is, 1.4 men for every one woman. The number of divorces for every 100 marriages has doubled from 25 to 50, one for every two marriages and still rising. The average marriage that breaks up lasts only seven years. This is the background for statements that the concept of female dependency is now meaningless and this sort of thinking occupied the minds and the intentions of the Advisory Council more than anything else. They were very seized up with this question of the position in which women were placed in the Social Security system. The women who have worked in the past have been paying taxes for benefits based on their work and those benefits have been offset against the spouse benefit. There has been great criticism - - especially if, having paid the taxes, these women wind up with no more benefits. So the Council looked at the alternative of a double-decker approach, that is, a plan in which everybody would get a "universal demogrant". (Demogrant is a word that means a payment to everybody in the population of a fixed amount. The figure that was bandied about was $122 a month, present minimum benefit under Social Security.) In addition there would have been a monthly income of 30% of the covered earnings base (AIME) of each worker - - a percentage that would not vary as between earnings levels. This would have provided a benefit to homemakers (the demogrant) plus benefits based on all taxed earnings. After quite a struggle, the Council rejected this and also rejected proposals for "homemaker credits" preferring the alternative of "earnings sharing".

Under this concept each spouse gets a benefit based on one-half of the couple's combined earnings while married, regardless of whether one or both spouses contributed to these earnings.

Since many aspects of this type of plan are not yet worked out, no specific broad-scale plan for earnings sharing is recommended at this stage. However the Council did recommend as a first step the splitting of earnings credits on divorce after at least 10 years of marriage even while the broad principle of what is proposed is being considered by the public and by Congress. This seems like an obvious thin edge of the wedge.

It has been said that the general effect of this proposal would be to provide lower benefits for men and higher benefits for women as well as shifts of benefits between classes of women. There would be a large measure of offset where couples stay together. But this would not be true in cases of break-up, disability or death. Homemakers are not now entitled to disability benefits; under earnings sharing they would be entitled to these benefits even though they had never been in the paid workforce. Under present law divorced women must have been married at least 10 years before being entitled to any benefit based on their retired ex-husband's credits; under full earnings sharing they would gain from each year of marriage.

The Council proposes that earnings sharing be on a compulsory basis. However their report does not define marriage. Common law marriages (living together), separations, trial, communal, homosexual and similar situations are undefined.

Because very large numbers of men would be the losers, a long transition period is proposed. Those retiring in the next 10 years would be protected against reduction. After that a transition formula would provide a faster rise in benefits based on shared earnings so that these would eventually prevail. The "transition guarantee" would be phased out by the year 2020. Only earnings after 1980 would be shared.

Eventual winners would include survivors of two-earner couples, divorced women and disabled homemakers (no earnings). Losers would include men and particularly divorced men. Women would have established the principle of marriage being a partnership of equals; would have independent benefits; would have gained disability, retirement and other benefits for homemakers; and would have eliminated the present conflict between the spouse's and own-right benefits in the case of working wives.

While much is undefined, a tentative net cost of 0.4% of payroll (some $4 billion annually at this time), "not including the cost of the transition" (which is not estimated), is ventured by the Council to cover the version of earnings sharing tentatively outlined.

Problems not dealt with include family benefits, non-covered employment earnings (e.g. by civil servants), survivors of late marriages, and the clear break with tradition as to the nature of marriage which is implied in this transfer of benefits from husbands to wives.

> "It is important not onlyfor policy makers and opinion leaders to understand that earnings sharing would mandate a transfer of benefits from husbands to wives and from divorced men to divorced women, but also for the millions of workers and beneficiaries to understand and endorse this change. By eliminating the concept of spousal dependency, and by providing benefits where no labour market earnings are lost, earnings sharing would represent a fundamental change in the philosophy of the Social Security system. Broad support of such fundamental change is essential to its success."

The Council defends the continued use of the payroll tax for cash benefits, which "helps to sustain the principle that Social Security benefits are an earned right". On this point the Council does not comment on the contradiction between (i) the "earned right" to benefits for which contributions have been made by the individual worker through these payroll taxes, and (ii) the stripping away of a portion of these benefits and transfer of them to another person, who may in due course be an ex-spouse, as would occur under the earnings-sharing proposals of the Council.

MR. MYERS: The treatment of men and women under Social Security is an extremely important matter. In my opinion, due to both legislative changes and court decisions, equality of treatment in this respect has now been achieved. Accordingly I do not see the necessity of making any changes in the law such as dividing earnings credits between spouses.

It is important to note that, under present law, benefits are paid to spouses and widowed spouses, not on the basis of dependency, but rather on the basis of legal relationship. The law itself does not use the word "dependency".

Mr. Thompson referred to the views of women's groups as strongly favoring earnings-sharing proposals. Actually there is by no means unanimity among women's groups in this respect. A large number of representatives of Mothers on the March testified before the National Commission on Social Security that they strongly object to this approach because it takes

benefits away from one group of women (those who are homemakers) and gives them to another group of women (those in two-worker families). In actuality these proposals do not transfer benefits from men and give them to women, but rather they transfer them between different categories of women.

MR. CALVERT: There is one aspect of this whole set of proposals being put forward by the Advisory Council that troubles me very much. I do not think that the long-range cost aspects have been handled at all strongly in their work.

Benefits are proposed to be liberalized in many directions, some inside the system and some outside it (such as enlarged SSI benefits and a new kind of unemployment benefit). The full extent of the expanded costs would not be apparent because they would take various new forms not comparable with each other, giving in all a deceptive and confusing quality to the result.

Consider for example:

Transfer of Hospital Insurance costs to "earmarked portion of income taxes" or "special income tax surcharge".

Contingent charge on "general revenue" during times of high unemployment (hence increased federal deficit, i.e. use of printing press directly feeding the inflation).

Borrowing power for trust funds (never needed before).

Unstated revenue source:
For special unemployment benefit
For various SSI liberalizations which are outside the Social Security system, hence extra pressure on federal budget (now in deficit).

Taxation of one half of all benefits as income.

This fragmentation and change in forms of cost will make comparisons and projections extremely difficult to prepare. But what is not difficult to sense is that the Council is proposing to continue the long-term process of expansion of the Social Security and related systems (i.e. the trend to welfarism and consumerism) and to give this claim on our national resources an overriding priority with almost no regard to the source from which all these benefits are to come.

You have all heard the immensely valuable comments of Haeworth Robertson about the long-term cost aspects. Surely these remarks deserve our closest attention. To add to this background, I would like to place another scenario before you.

At the present time, commitments have been made to persons covered under the Social Security system amounting to $3 trillion in all, for benefits already accrued. This figure continues to grow. There are no significant assets. These benefits will have to be made good from future production.

In addition unfunded pension liabilities exist under the more than sixty federal civil service retirement systems, the military retirement system and the great number of state and local government retirement systems, amounting in all to a further $1 trillion, so that in all, this nation is committed to $4 trillion in already-accrued benefits, for which there are no assets and which will have to come out of future production. This is twice the entire Gross National Product of the nation!

Production comes from a blend of Land (resources), Labor (the workforce) and Capital - with a dash of Motivation. As we look into the next two or three decades and consider how the $4 trillion worth of purchasing power is going to be produced, we seem to be confronted with these prospects:

Land (resources): The prospect of depletion and running out of various types of energy resources. A topping out of yield per acre of croplands. Deforestation. A net loss of productive land, as deserts continue to expand at the margin. A great and costly struggle to replace energy sources. The need to develop substitute materials, as metal becomes more difficult to obtain. Increasing dependence on foreign sources of supply, with consequent political risks of supply interruption.

Some encouraging signs, but yellow lights flashing.

Labor (work force): Adequate growth for a decade, followed by at least a decade of shrinking supply of new workers, perhaps continuing and worsening, notwithstanding higher proportion of women at work and stepped-up immigration. Possible efforts to stimulate birth rates or lowering of immigration standards.

Some encouraging signs, but yellow lights flashing.

Capital (industrial): Plunge in capital/worker ratio will take mighty effort to reverse. Perception of need only now beginning. Enormous call for new capital for whole new generation of energy-related industries. Urgent pressure for vast capital for third world, to establish industries there. Source has to be from savings and investment. Can there possibly be enough?

Some encouraging signs, but yellow lights flashing.

Motivation (to work, save) : Inflation pushing workers into ever higher tax brackets, discouraging further effort. Social Security retirement test discouraging work after 65. Disability benefits higher than full-time earnings, inhibiting recovery and return to work. Welfare at high levels also. Combination of federal, state, local taxes becoming confiscatory, and prospects of much more to come. Savings produce negative investment return. Double taxation of dividends. Non-inflation-adjusted depreciation allowances. Labyrinth of government regulations strangling enterprise.

Red and yellow lights flashing. Where are the encouraging signs?

When we consider the mammoth commitment that has been made to provide all these $4 trillion worth of benefits --yes, indexed benefits that will not lose any of their claim on future goods and services and will in fact

increase that claim through faulty indexing-- and when we compare the relentless certainty of these commitments in this era of "entitlement" to the uncertainties and the problems that we will have to overcome to make good on them, does it not become apparent that we have some rethinking to do, such as in the benefit area?

Where will we find the solution to this problem, this compulsive tendency to national overcommitment of benefits without means of support? I believe that in coming decades we will see continuing social changes, including changes in the patterns of work and retirement. Gradually society will have to adjust to the new realities. Present indications seem to call in the long run for:

A breaking-up of the solid block of education at the outset and a spreading of the process of education at intervals throughout life to keep abreast of newly emerging technology.

A fragmentation of the solid block of leisure (retirement) at the latter end of life and a scattering of the resulting fragments back through the "working years", to be used for education, travel, sabbaticals and family activities.

A gradual phasing out of the work-life from full-time to part-time work, then eventual full retirement.

A dovetailing (gradual phasing in) of tax-based pensions to conform to this pattern, thus providing both tax relief, decreased exposure to inflation, a more suitable answer to the mandatory retirement problem than an indefinite continuation of full-time work, and much psychological satisfaction to retirees.

Herein, I believe, we may be able to find the answer to the problem of an overload of pension commitments in the future.

QUESTION: The Consumer Price Index is used to adjust Social Security benefits. Is the CPI an accurate indicator of inflation?

MR. CALVERT: I not only have some comments on this subject; I also have some material with me that deals with it. I would suggest you all get copies of the magazine "Electric Perspectives 78/5" published by Edison Electric Institute in New York. This contains two excellent articles, by Lee Moore and Professor Gordon, showing how the CPI is biased upwards by at least 2% a year. It is in no way an accurate measure of changes in the cost of living. Its continued use for that purpose is doing great damage to the economy and feeding the inflation. Just to take one example, the cost of a motor tire in 1935 was $13 and it delivered 7,000 miles. In 1978 the cost was $68 and it delivered 40,000 miles. Ignoring this change in performance, the CPI tire price index rose by 140% but the cost per mile fell by 9%. Scores of similar examples can be given. The CPI includes many kinds of taxation but gives no credit at all for what we receive in return for these taxes. With all its fateful impact on the economy and on the inflation, the CPI is a highly incomplete, inaccurate and misleading gauge, which is connected with the actual cost of living only in a crude and indirect way. I have prepared an article about all of this which I am told will appear in the January 1980 issue of The Actuary magazine. If we are serious about

getting the inflation under control, surely this is one place where we can start.

MR. DALE C. GRIFFIN AND MR. CECIL J. NESBITT: Discussion Note - -

Our discussion concerns the immediate and the long term consequences of arrangements under which the employer pays the employee's FICA tax without deduction of this tax from the employee's earnings. Such a payment by the employer is specifically excluded from FICA tax, but it is subject to income tax for the employee. Up till now the effect of the exclusion has been relatively minor, but with the recent rapid rise in FICA taxes some attempts are being made to exploit the exclusion to effect savings in the FICA taxes payable. There has been a series of articles, promotions and discussions of the idea that if an employee's wages are X ($X <$ maximum taxable wage), S is the FICA tax rate payable by each of the employee and the employer, and if the employee's wages were reduced to Y and the employer paid both shares of the FICA tax, then there would be a net savings of

$$2SX - 2SY = 2S(X - Y)$$

in FICA taxes (see sources [1] - [5] listed at the end of the discussion). Most articles suggest that the employer would receive all the savings (see [3]) but a few suggest sharing the savings between the employer and the employee ([1], [2]). Some promotions ignore, or pay little attention to, the fact that the employee's wage record for the year would be reduced by $X - Y$, and the employee's future benefits would suffer some diminution. To see what is going on, we shall set up a mathematical relation between the original wages X and the reduced wages Y, and then will specialize the relation to three cases that have been discussed in one or more of the articles, and which have a natural interpretation.

Besides the loss in benefits for the employees (as indicated in the table and by our own calculations), there are a number of other disadvantages and complications if an employer seeks to save on FICA taxes by wage reduction and assumption of the total FICA tax burden. These have been discussed in [4], [5] and will not be detailed here. If the practice became national in scope, the Social Security System would lose more in FICA taxes (currently $2(.0613)^2 \doteq 0.7\%$ of payroll for employees with wages below the maximum taxable earnings) than it would gain in reduced benefits, because the tax rate is calculated to support benefits of 90%, 32% and 15% of earnings levels, and the reduction in benefits would be mainly at the levels for the 15% and 32% factors. Moreover the loss in tax income would immediately affect cash flow while the reduction in benefits would have deferred effects. There might soon result the need for an increase in FICA taxes which would eliminate some of the tax savings. For these and other reasons, there is a strong possibility that Congress will close this tax loophole. In our opinion it would be unwise for an employer to seek to gain by it at this time.

MATHEMATICAL RELATIONS

Consider the savings (in FICA tax) to consist of $gS(X - Y)$ savings for the employee and $(2 - g)S(X - Y)$ for the employer, for a total of $2S(X - Y)$ of savings.

	General	Case A, g=0	Case B, g=1	Case C, g=2
1. Principle	The employee's net pay after FICA tax but before income tax increases by $Y-X(1-S) = gS(X-Y)$ Both sides represent the employee's savings. By subtracting each side from the total savings $2S(X-Y)$, we get $X+SX-(Y+2SY)=(2-g)S(X-Y)$ where now each side represents the employer's savings. These formulas reduce to $Y(1+gS)=X[1+(g-1)S]$ or $Y=X\ \frac{1+(g-1)\ S}{1+gS}$.	$Y=X(1-S)$ Wages are reduced by the employee's FICA tax on the <u>original</u> wage.	$Y(1+S)=X$ Wages are reduced by the employee's FICA tax on the reduced wage.	$Y(1+2S)=X(1+S)$ The employer's costs are the same before and after the reduction, and all the savings in FICA tax go to the employee.

	General	Case A, g=0	Case B, g=1	Case C, g=2
1. (cont'd.)		The employee's net pay (after FICA tax) is the same before and after the wage reduction. This has been the most common proposal.	Gross pay (for income tax) is the same before and after reduction.	Gross pay is increased (see next item.)
2. Employee's gross pay for income tax.	$Y(1+S)$ $=X\frac{1+(g-1)S}{1+gS}(1+S)$ $=X\left[1+\frac{(g-1)S^2}{1+gS}\right]$	$X(1-S^2)$	X	$X(1+\frac{S^2}{1+2S})$
3. Total FICA tax savings	$2S(X-Y)=2SX\left[1-\frac{1+(g-1)S}{1+gS}\right]$ $=\frac{2S^2X}{1+gS}$	$2S^2X$	$\frac{2S^2X}{1+S}$	$\frac{2S^2X}{1+2S}$
4. Employer's share of FICA tax savings	$X(1+S)-Y(1+2S)$ $=(2-g)\frac{S^2X}{1+gS}$	$2S^2X$	$\frac{S^2X}{1+S}$	0
5. Employee's share of FICA tax savings	$(3)-(4)=g\frac{S^2X}{1+gS}$	0	$\frac{S^2X}{1+S}$	$\frac{2S^2X}{1+2S}$
6. Increase (decrease) in employee's income tax	Tax on the $\frac{(g-1)S^2X}{1+gS}$ increase in gross pay	(Tax on S^2X)	0	Tax on $\frac{S^2X}{1+2S}$

	General	Case A, g=0	Case B, g=1	Case C, g=2
7. Increase in employee's take home pay.	(5) - (6)	Tax on s^2x	$\frac{s^2x}{1+s}$	$\frac{2s^2x}{1+2s}$ - (tax on $\frac{s^2x}{1+2s}$)
8. Ratio of value of loss in future Social Security benefits to value of gain in take home pay.		Much larger than for Cases B and C. This case is unfair to the employees who, as offset to their loss in benefits, gain only a dab of income tax savings (but no FICA tax savings).	Nearly twice as large as for Case C since gain in take home pay is only about one half that in Case C.	R. Foster's illustration shows ratios from .52 to 1.60 (see [1]). Even in this most favorable case some employees will lose more in benefits than they gain in take home pay.

SOURCES

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4. Meidinger and Associates, Inc., FICA Tax Reduction Plan Revisited, Social Security News 79-10, September, 1979.

5. TPF&C, Employer Payment of Employees' FICA Taxes Can Cut Payroll Costs - and Create Problems, TPF&C Letter, Issue 172, United States Edition, August 27, 1979.