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U.S. SOCIAL SECURITY ISSUES

Moderator: JAMES C. HICKMAN. Panelists: DWIGHT K. BARTLETT III, WARREN R. LUCKNER, BRUCE D. SCHOBEL

1. What is the financial status of the Social Security program?

2. What changes have been recently adopted and what changes have been proposed?

3. How would these changes affect the private pension system - costs and plan design?

4. What is the proper role of the actuarial profession regarding the Social Security program?

The following papers will be referenced in this discussion:

"OASDI Earnings Test", by Warren R. Luckner

"Measures of Actuarial Status for Social Security: Retrospect and Prospect", by Dwight K. Bartlett III

MR. JAMES C. HICKMAN: I will start this session by reporting some headlines. Lest anybody forget, Social Security is big. Secondly, Social Security is important. It is important to us because we are all taxpayers. It is important to us because, at least in my case, my parents received benefits and it is important to us as professionals who work designing financial security systems. Finally, Social Security is troubled. If you do not believe it, all you have to do is read the newspaper. Around those points of big, important, and troubled, much of our discussion will proceed this morning. We will restrict our attention primarily to OASDI, the Old Age Survivor and Disability Insurance System. Relatively little will be said about the health insurance system (HI). This is not because it is not big, not important, or not troubled, but simply because we are bounded by 90 minutes.

The social security system is enormous. Its macroeconomic effect is massive and its influence on the society of the U. S. is pervasive. Therefore, when one discusses proposed changes in the U. S. social security system, it is necessary to start with an examination of the forces shaping our society.

At the beginning of this century it was said that the only agency of the federal government that affected the daily lives of most citizens was the postal service. The events of the past 81 years have changed, probably irrevocably, that simple state of affairs.

The population of the United States is about three times what it was in 1900. The nation has been changed by two global wars, two major military actions in Asia, a prolonged cold war, a great depression, a period of remarkable economic growth followed by stagnation, and by profound social changes involving the relationships among the races and between the sexes. With these changes have come concomitant adjustments in the institutions that serve society. The golden age of stability has not commenced.

In this session we are discussing social security, a federal institution affecting the lives of most U. S. citizens, whose history mirrors many of the political, social and economic trends of the past 47 years. It was created by Congress in 1935 during the middle of the Great Depression. Of the enactments that made up the New Deal, it is the principal survivor. Although disability, and later old age health benefits, have been added, and the relative weight given to individual equity and social adequacy have shifted, the main elements of the core old age income program have remained remarkably unchanged.

One needs to go no further than the program of this meeting to identify some of the trends that are affecting social security and private benefit plans. These trends will be illustrated with tables taken from the 1980 Statistical Abstract of the United States and identified by table number.

1. Mortality Improvement

2. Low Fertility

Workshop 4 is devoted to group life mortality and Open Forum 5 and its follow-up Workshop 18, are devoted to retirement age issues. These topics, at least in part, are reflections of the two great demographic facts of the past decade, mortality improvement and low fertility.

3. Increased Labor Force Participation by Women

4. Increased Rate of Divorce

These two social trends, which are certainly not independent of trend 2, are behind Workshop 3, Pensions and Divorce.

5. Lower Rate of Growth of Real Income

Panel Discussion 9 is devoted to the Economic Recovery Tax Act of 1981. The Reagan administration's response to the hard fact, that in real terms, U. S. median family income has remained virtually unchanged in the decade of the 1970's.

These five trends have persisted long enough so that they cannot be termed random fluctuations. Their influence is felt by all the citizens and institutions that make up U. S. society. The adaptation of social security to these trends will be made by the political process. This means that the adaptations will involve compromise. The attainment of no single goal will be the dominant objective.

Clearly the exact form of the adaptation is not known. However, the elements of the response to the trends are known and, in fact, have been discussed for years. William C. Greenough (1982) has made the point that there is a rather wide consensus on these elements.

TREND 1

MORTALITY IMPROVEMENT
COMPLETE LIFE EXPECTANCIES, AGE 65, WHITES

	1939-41	1949-51	1959-61	1969-71	1975	1979
MEN	12.1	12.8	13.0	13.0	13.7	14.0
WOMEN	13.6	15.0	15.9	16.9	18.1	18.4

SOURCE: 1980 STATISTICAL ABSTRACT OF U.S., TABLE 107.

TREND 2
FERTILITY

1940-44	1945-49	1950-54	1955-59	1960-64	1965-69	1970-74	1975-78
2.523	2.985	3.337	3.690	3.449	2.622	2.106	1.769

SOURCE: 1980 STATISTICAL ABSTRACT OF THE U.S., TABLE 86.

TREND 3

LABOR FORCE PARTICIPATION,
PERCENTAGES OF WOMEN IN LABOR FORCE BY
AGE AND YEAR GROUPS

	16-19	20-24	25-34	35-44	45-54	55-64	65
1960	39.1	46.1	35.8	43.1	49.3	36.7	10.5
1965	37.7	49.7	38.5	45.9	50.5	40.6	9.5
1970	43.7	57.5	44.8	50.9	54.0	42.5	9.2
1975	49.0	63.9	54.3	55.6	54.3	40.6	7.8
1979	54.3	69.0	63.6	63.2	58.1	41.5	7.8

SOURCE: 1980 STATISTICAL ABSTRACT OF U.S., TABLE 653.

TREND 4

DIVORCE
RATE PER 1,000 MARRIED WOMEN AGE 15 AND UP

1950	1955	1960	1965	1970	1975	1978
10.3	9.3	9.2	10.6	14.9	21.1	21.9

SOURCE: 1980 STATISTICAL ABSTRACT OF U.S., TABLE 123.

TREND 5

MEDIAN FAMILY INCOME
(1980 DOLLARS)

1960	15,637
1970	20,939
1980	21,023

SOURCE: U.S. CENSUS BUREAU.

1. Shifting up the Distribution of Retirement Ages

Trends 1, 2 and 5 are combining to create pressure to reverse the movement of the distribution of retirement ages downward. Increased expected longevity and price inflation motivates persons with only part of their retirement income indexed to delay retirement to reduce the length of their exposure to declines in real income. A counter force arises from the need to make large reductions in the work forces of several major industries, in response to new economic realities, and early retirement is a humane method of making the needed adjustments. Nonetheless, it seems that the trends listed will prevail and lead to a policy of pushing the distribution of retirement ages upward.

In developing such a policy one starts with adjusting the controls and inducements that already exist within social security. Beside the normal retirement age, these instruments of policy include the earnings test, the early retirement decrement, and the late retirement increment. Of course, there are other possible components of such a policy. These include the age at which a double income tax exemption is permitted, the age at which funds sheltered from income tax, because of their dedication to retirement, may be withdrawn without tax penalty, the upper age limit on mandatory retirement, and tax policy toward social security benefits.

2. Changes in Indexing

Trend 5 is causing many to re-examine the two indexing systems used in social security. Currently a wage index system is in use in defining averaged indexed earnings and in shifting upward the concave PIA graph. A consumers' price index is used in the annual revision of benefit amounts being paid. The discussion leading to the resolution of the "decoupling issue" by the 1977 amendments centered on the relative merits of a wage or price index system for computing initial benefits. Those supporting a wage indexed system referred to the desirability of a stable distribution of replacement ratios. Those favoring a price indexed system referred to the desirability of stabilizing the distribution of real retirement incomes. The supporters of a price indexed system were not dismayed by the bias toward a downward drift in the distribution of replacement ratios. They anticipated that social security would benefit from some fiscal flexibility in adjusting to unexpected future demands. The essential arguments, summarized by Trowbridge and Moorhead (1977), are still relevant.

The discontinuity between the movement of average wage income and consumer prices in several recent years has captured public attention. Suggestions that a general consumer price index may not be based on a market basket of goods and services appropriate for retired lives have also been pressed. Revision of the market basket to, for example, attach less weight to new home prices is now underway. However, the basic issue is not technical. Instead it is, should retired lives be sheltered from a period of collective belt-tightening? If a decline in real wages should persist, the answer is clearly no. At its heart the issue is how to use the index systems to spread the gains when real incomes increase and the losses when real incomes decline.

3. Family Income Splitting

Trends 3 and 4 have been behind several proposals for revising social security benefits for marriage partners. The 1979 Advisory Council Report is an excellent source for a review of these social trends and the suggested changes in social security spawned by these trends.

It is traditional that any change in the benefit structure comes with a transition arrangement such that beneficiaries receive the maximum of benefits under the old and new structures. Since most of the proposals within this class involve somewhat higher cost and a long and difficult transition, the pressure for their enactment has receded when financing has been inadequate to balance existing benefits. However, trends 3 and 4 have not reversed and proposals for revising benefits for marriage partners will be reintroduced.

Most of the proposals call for splitting earnings credits between marriage partners for benefit purposes. Each person's social security protection would be based on his/her own earnings record while unmarried and one-half of the combined earnings record while married. Modifications seem necessary to achieve adequate benefits for disabled beneficiaries.

Most persons who have studied family income splitting proposals find much to commend in the concept but they are soon struck by the many technical and transitional problems. However, as long as trends 3 and 4 continue, a related political pressure for a continuous method of allocating social security benefits to marriage partners that avoid an arbitrary time limit (10 years) before benefits accrue to a divorced spouse.

The experience of the Reagan administration in the late spring of 1981 demonstrates that abrupt changes in social security are almost politically impossible. With a political expectation, bottomed on the payroll tax, most working citizens perceive an entitlement to social security benefits that does extend to other government programs. However, the need for adjusting the social security system to the trends changing society is pressing. A fairly broad consensus on the main elements of the adjustment has been reached. Now the job is to explain the problems and how they may be managed to our fellow citizens.

References

Greenough, William C. "Pensions, What Now?" Journal of Risk and Insurance, Vol. 49 (1982).

Moorhead, E. J., and Trowbridge, C. L., "The Unresolved De-Coupling Issue" TSA, Vol. 29 (1977).

Report of the Quadrennial Advisory Council on Social Security, USGPO, January 1980.

MR. DWIGHT K. BARTLETT III: I was motivated to write my paper, "Measures of Actuarial Status for Social Security: Retrospect and Prospect", not only because I felt it is an interesting historical subject, but also because there is less of a consensus today about how to measure the actuarial status of Social Security than there has been traditionally. There are two aspects

TABLE I

ESTIMATED OPERATIONS OF OASI TRUST FUND UNDER ALTERNATIVE II-B IN 1982 TRUSTEES REPORT, 1981-86

(AMOUNTS IN BILLIONS)

CALENDAR YEAR	INCOME	OUTGO	CHANGE	FUND AT END OF YEAR	TRUST FUND RATIO
1981	$125.4	$126.7	-$1.3	$21.5	18%
1982	137.1	141.8	-4.7	16.8	15
1983	137.0	156.4	-19.4	-2.6	11
1984	149.1	173.2	-24.0	-26.6	-1
1985	167.1	191.1	-23.9	-50.5	-14
1986	180.7	208.5	-27.9	-78.4	-24

NOTE: ESTIMATES FOR 1983 AND LATER ARE THEORETICAL BECAUSE THE OASI TRUST FUND IS DEPLETED IN JULY, 1983.

TABLE 2

ESTIMATED OPERATIONS OF DI TRUST FUND UNDER ALTERNATIVE II-B IN 1982 TRUSTEES REPORT, 1981-86

(AMOUNTS IN BILLIONS)

CALENDAR YEAR	INCOME	OUTGO	CHANGE	FUND AT END OF YEAR	TRUST FUND RATIO
1981	$17.1	$17.7	-$0.6	$ 3.0	21%
1982	17.0	18.5	-1.5	1.6	16
1983	26.1	19.1	7.1	8.6	8
1984	29.5	20.1	9.4	18.0	43
1985	37.3	21.5	15.9	33.9	84
1986	41.8	22.9	18.9	52.8	148

GRAPH I

ESTIMATED TRUST FUND RATIOS FOR OASI, DI, AND HI PROGRAMS, COMBINED, UNDER ALTERNATIVES I, II-A, II-B, AND III IN 1982 TRUSTEES REPORTS, 1982-91

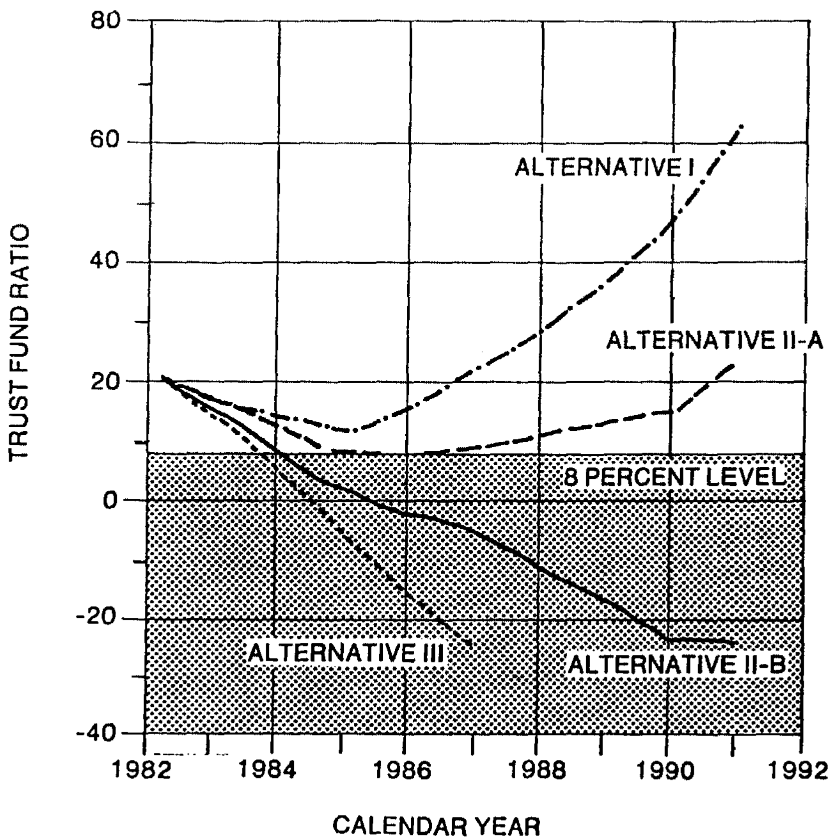


TABLE 3

ESTIMATED OPERATIONS OF OASI, DI, AND HI TRUST FUNDS, COMBINED, UNDER ALTERNATIVE II-B IN 1982 TRUSTEES REPORTS 1981-86

(AMOUNTS IN BILLIONS)

CALENDAR YEAR	INCOME	OUTGO	CHANGE	FUND AT END OF YEAR	TRUST FUND RATIO
1981	$178.2	$175.1	$3.1	$43.3	23%
1982	186.9	195.9	-9.1	34.2	22
1983	205.4	217.1	-11.7	22.5	16
1984	224.8	241.6	-16.8	5.7	9
1985	256.0	268.1	-12.1	-6.4	2
1986	281.8	294.8	-13.1	-19.4	-2

NOTE: ESTIMATES FOR 1983 AND LATER ARE THEORETICAL BECAUSE THE OASI TRUST FUND IS DEPLETED IN JULY, 1983.

TABLE 4

OASDI AVERAGE SCHEDULED TAX RATES AND ESTIMATED AVERAGE COST RATES UNDER ALTERNATIVE II-B IN 1982 TRUSTEES REPORT

[IN PERCENT OF TAXABLE PAYROLL]

CALENDAR YEARS	AVERAGE COST RATE OASI	DI	TOTAL	AVERAGE TAX RATE	DIFFERENCE
1982-2006	10.14	1.23	11.37	12.01	+0.64
2007-2031	12.43	1.65	14.08	12.40	-1.68
2032-2056	15.20	1.61	16.81	12.40	-4.41
1982-2056	12.59	1.50	14.09	12.27	-1.82

GRAPH 2

OASDI SCHEDULED TAX RATES AND ESTIMATED COST RATES UNDER ALTERNATIVES I, II-A, II-B, AND III IN 1982 TRUSTEES REPORT, 1982-2060

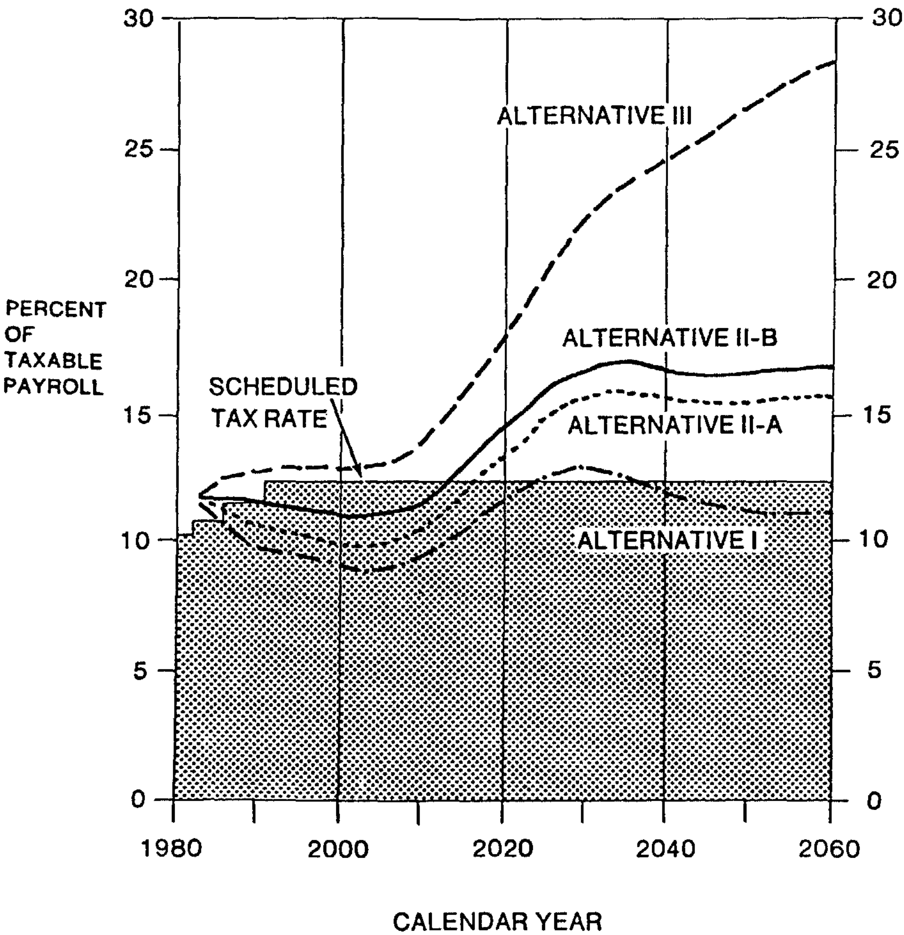


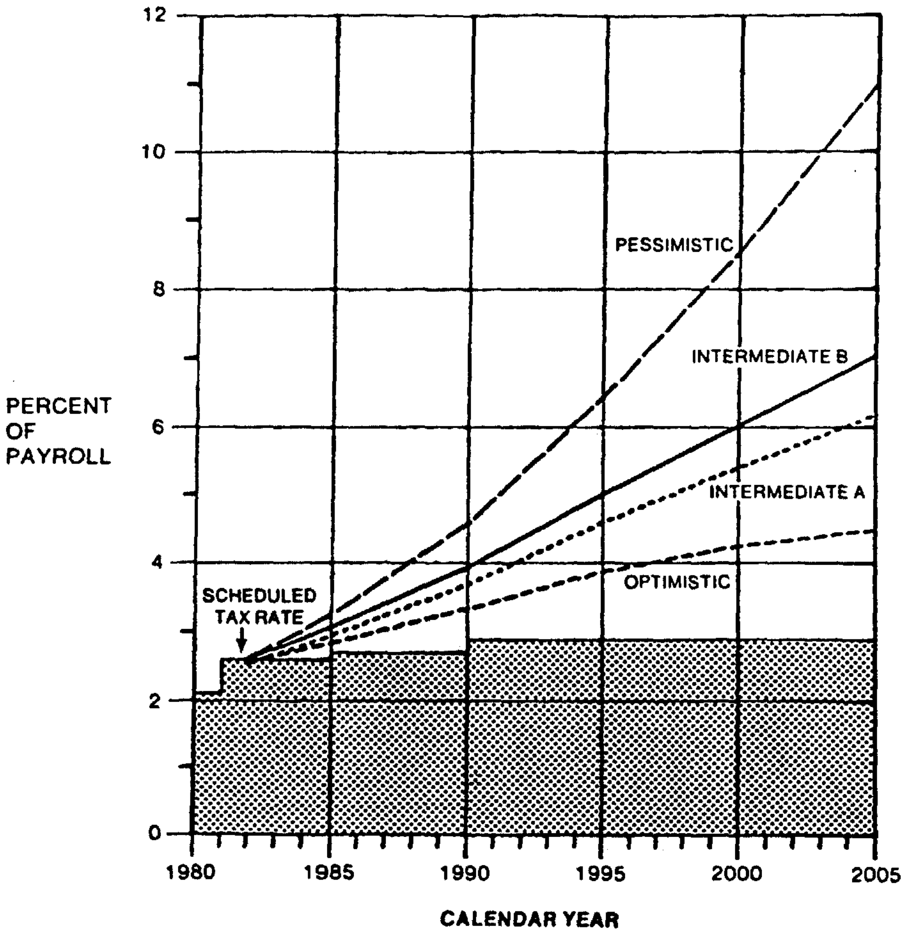
TABLE 5

ESTIMATED ACTUARIAL BALANCE FOR 1982-2006 UNDER ALTERNATIVE II-B IN 1982 TRUSTEES REPORTS

	PERCENT OF TAXABLE PAYROLL	
	OASDI	HI
• AVERAGE SCHEDULED TAX RATE.	12.01%	2.86%
• AVERAGE COST RATE.	11.37	4.81
• ACTUARIAL BALANCE.	0.64	-1.95

GRAPH 3

ESTIMATED HI OUTGO AND TAX RATES 1982-2005



to the question. The first is determining when corrective action is indicated, and the second is how much corrective action is required.

Traditionally, the measure of the short-range actuarial status for Social Security has been the trust fund ratios. The trust fund ratios are defined as the assets in each trust fund divided by its projected expenditures for the year in question. The short-range projections for these trust fund ratios are made for five years in the trustees' reports. Until interfund borrowing authority was legislated recently, each trust fund: Old Age and Survivors Insurance, Disability Insurance, and Hospital Insurance, stood entirely on its own, receiving an allocated portion of the payroll tax rates as specified in the law and being charged, of course, with its own benefits and expenses. Short-range projections for OASI and DI taken from the 1982 Annual Report of the Social Security Trustees are shown in Tables 1 and 2. Now that the trustees for Social Security have limited interfund borrowing authority, it is also relevant to look at the combined trust fund ratio for OASI, DI and Hospital Insurance (HI) combined. These are shown in Table 3 and Graph 1.

Note that because of uncertainty about the future economic and demographic experience of the program, the projections are made under three sets of demographic assumptions and four sets of economic assumptions. Alternative I assumptions are the most optimistic and alternative III are the most pessimistic. I would characterize alternative II-B assumptions as "best guess" assumptions, although the trustees do not. As amazing as it seems, considering the information in the most recent trustees' report, there are those such as Senator Daniel Patrick Moynihan and Mr. Robert Ball, the former Commissioner of Social Security, both who are members of the new National Commission on Social Security Reform, who argue that there is no serious short-range financing crisis for Social Security. This is in spite of the fact that under pessimistic assumptions, even with interfund borrowing, the trust funds are projected as being exhausted. We, therefore, are reduced to arguing about which assumptions to use in making judgments about the short-range actuarial status of Social Security. Mr. Ball and Senator Moynihan have chosen to focus on the projections based on the Administration's budget forecast, the basis for the II-A projections.

Clearly, the Administration was motivated by a desire to avoid a repetition of the short-range financing problems which followed the 1977 amendments when, in early 1981, it prepared its recommendations about short-range financing based on what it characterized as "worst case" assumptions. This was a departure from the tradition of basing financing decisions on the intermediate assumptions. That tradition was unchallenged at a time when there was no question about the short-range solvency of the trust funds, but that is no longer the situation. My own preference would be to continue to use the intermediate assumptions, but to set short-range trust fund targets which would provide a high degree of assurance that short-range financing would be adequate. I did some analysis of the assumed vs. actual experience of the program in the 1970's with respect to the short-range economic assumptions used in the trustees' reports of this era. The results were included in a publication, "Economic Forecastings: Effects of Errors on OASDI Fund Ratios", Bartlett and Applebaum Actuarial Note No. 109, Social Security Administration, September 1981. The results of that study may be useful in setting short-range trust fund ratio targets. They suggest 50% as a minimum.

The traditional measure of the long-range actuarial status of OASDI is based on 75-year projections. The projected annual program expenditures are expressed as a percent of projected covered wages and then averaged over the entire period as well as appropriate subperiods. The results in this form can then be directly compared to the combined employer and employee tax rates as is done in Table 4 and Graph 2. OASDI combined is said to be in "close actuarial balance" if average projected expenditures as a percentage of projected covered wages are within 5% of average tax rates. In the paper I have suggested that this may be too narrow a range for 75 years although it may be appropriate for 25 years. Even if the range is broadened out to 10% for the 75-year period, OASDI is not in close actuarial balance, except under optimistic assumptions.

The long-range projection period for HI is limited to 25 years because of the difficulty in projecting hospital costs for longer periods. Even for this more limited period, HI is not in close actuarial balance as is shown in Table 5 and Graph 3. Furthermore, after the turn of the century, the HI program will be impacted adversely for the same reason that the OASDI program is not in close actuarial balance. That is, the baby boom generation of the 1940's, 50's and 60's will be changing from taxpayers to beneficiaries beginning primarily in the second decade of the next century.

It is, of course, possible that these long-range problems will, in fact, not materialize. It is possible that birth rates will take a dramatic upswing, real wage growth will match or exceed historical trends, legal and illegal immigration will accelerate to produce more taxpaying workers, etc. Because of the social insurance nature of the program, however, with its implied commitments, we should be making conservative financing arrangements under reasonable assumptions with the option of making later liberalizations if experience warrants it.

In summary, it is clear that there are both short-range and long-range financing problems for Social Security, under any reasonable measures. It would help reduce the level of argument, if a consensus could be reached as to what are appropriate measures and what their critical values are so that timely and appropriate corrective measures can be taken.

MR. BRUCE D. SCHOBEL: I will be restricting my remarks today to the OASDI program, although there has been some legislative activity in other areas, for example, HI and SSI. The OASDI program has been the focus of relatively more legislative activity in the last few years, and it is most immediately in need of more changes.

To give some idea of the amount of Congressional interest in Social Security, consider that in 1981, more than 1,000 Social Security-related bills were introduced in the Congress, and 47 related hearings were held. Two major pieces of legislation were enacted.

Before describing those in detail, I would like to just briefly mention the four significant pieces of OASDI-related legislation enacted in 1980:

1. The Disability Amendments of 1980 (Public Law 96-265) made major changes in the DI program. Most of these were intended to increase incentives for disabled beneficiaries to return to work and to decrease incentives for impaired workers to file for benefits. This law also mandated the periodic reviews of

beneficiaries' eligibility that have caused such uproar in the last year.

2. The Tax Reallocation Act (P.L. 96-403) was a 1-page law that simply reallocated a portion of the DI tax for 1980 and 1981 to the OASI program. The total tax rate was not changed. This was one of the many stop-gap measures used to delay the approaching OASI inability to pay benefits on time, sometimes referred to as bankruptcy, although that description is not entirely accurate.

3. P.L. 96-473 reinstated the monthly earnings test in the first year of entitlement and prohibited the payment of most benefits to prisoners convicted of felonies. The payment of benefits to prisoners was mentioned in the Carter-Reagan debate of October 28, 1980, and neither candidate seemed aware that such benefits had been eliminated by a law signed by President Carter just 9 days earlier.

4. The Omnibus Reconciliation Act of 1980 (P.L. 96-499) made many changes in Medicare but really only one in OASDI--a reduction in the maximum number of months of retroactive benefits from 12 to 6, except generally for the disabled and their families, for whom the maximum number of months remained 12.

The first major piece of OASDI-related legislation last year was the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35). This nearly 600-page law affected almost every government program in some way. Ten sections related directly to OASDI, and I will describe them in the same order that they appear in the law, although that is, by no means, the order of importance in terms of impact, either political or financial.

1. Section 2201 eliminated the regular-minimum PIA for both current recipients (after February 1982) and future recipients (after October 1981). A special SSI benefit was provided for certain of these persons at ages 60-64. It should be noted that the minimum PIA had been phasing-out already because it was frozen at $122 by the 1977 Amendments; however, this 1981 Act eliminated it without any phaseout or transition. Benefits to affected persons would not drop to zero, of course, but would equal whatever was produced by the regular benefit formula.

2. The next section provided that the $255 lump-sum death benefit may be paid only to a spouse living with the worker at the time of death or to a child with immediate eligibility for monthly benefits. It had been previously payable to any person, including a funeral-home director, who provided for the burial expenses of the worker.

3. Another change is that workers and their spouses may not receive benefits for a month unless they are eligible throughout the month. The previous requirement was for eligibility to have occurred during the month. The effect of this section, in the vast majority (97%) of the cases, is to force people to wait a month to receive benefits, but their benefits will be somewhat larger because one fewer month of actuarial reduction will be applicable.

4. The age at which the retirement earnings test would no longer apply had been scheduled to drop from 72 to 70 in 1982 (as a result of the 1977 Amendments). The Omnibus Budget Reconciliation Act of 1981 delayed this change until 1983.

5. Section 2205 provided that, after a short transition, the entitlement of mothers and fathers to benefits will cease when the youngest child attains age 16, rather than 18 as under previous law. If a disabled child is present, entitlement of the mother or father would still continue, regardless of the child's age.

6. Section 2206 provided new rounding rules. Under previous law, benefits were rounded up to the nearest dime at every step of the computation. Under the new law, benefits are rounded down to the nearest dime at intermediate steps, and down to the nearest dollar at the final step.

7. The next section, a relatively minor one to SSA but probably important to pension plan administrators, authorizes SSA to charge the <u>full</u> cost, rather than a limited fee as under the Privacy Act, of providing information for any purpose not directly related to the administration of the programs under the Social Security Act. This section applies to requests by pension plan administrators for earnings records, as well as to most other requests. In fact, SSA is now charging individuals for the cost of providing their own earnings records in most cases where more than a summary statement is requested.

8. Section 2208, a relatively major section, extended the previous workers' compensation offset provision to include, for purposes of offset, certain benefits payable under Federal, State, or local government programs. Notable exceptions from the offset provision are Veterans Administration benefits and means-tested (welfare) benefits. In addition, the age at which offset would end was raised from 62 to 65, the age at which DI benefits are automatically converted to OASI benefits.

9. The procedure for reimbursing States for Vocational Rehabilitation services was changed so that the DI Trust Fund can only pay for "successful" rehabilitations, defined as those cases where the beneficiary engaged in substantial gainful activity for 9 continuous months <u>and</u> the VR services contributed to the return to work.

10. Finally, section 2210 provided for the phaseout of benefits to post-secondary students. Those on the rolls before May 1982 will have their benefits reduced 25% each year as long as they remain eligible. After the transition period, benefits to students will not be payable beyond attainment of age 19, and then only for those attending elementary and high schools full-time. This section also provided for non-payment of benefits for the months May through August.

Of the 10 sections of P.L. 97-35 which affected OASDI, the one repealing the regular-minimum benefit caused the loudest protests. Almost immediately after passage, and before the President had even signed the bill, literally dozens of new bills and resolutions were introduced in Congress to restore the minimum benefit, at least for those who were already receiving it and who were to have their benefits reduced in March 1982. Although agreement was reached very quickly that the minimum benefit should be at least partially restored, the Administration and some members of Congress insisted on finding some source of funding for the cost of this restoration. In addition, the latest cost estimates from the actuaries at SSA indicated that the OASI Trust Fund would still become unable to pay timely benefits in late 1982, even after all of the reductions included in P.L. 97-35.

In December, Congress enacted and the President signed the Social Security Amendments of 1981 (P.L. 97-123), which addressed all three of these concerns. First, the law restored the minimum benefit for those who became eligible before 1982. Thus, no current beneficiaries would have their checks reduced. To pay for this provision, the law provided for the taxing (for Social Security purposes) of the first six months of sick pay, including payments by insurance companies and payments under State temporary disability insurance laws, but excluding any portion paid for by employee contributions. Taxing sick pay actually will not produce enough revenue initially to offset the cost of restoring the minimum benefit. In the long run, however, the minimum benefit would have disappeared under previous law anyway, but the taxation of sick payment will continue forever, unless the law is changed.

The third major section of P.L. 97-123 provided for interfund borrowing among the OASI, DI, and HI Trust Funds, through December 31, 1982, with a provision for repayment with interest. The Conference Report on the law, which is generally considered to be binding, limits the amount of borrowing by specifying that, "In no case shall such interfund borrowing make adjustments in the trust funds insuring benefit payments for a period more than 6 months beyond the date of such determination." In other words, because borrowing is not permitted after December 1982 and because benefit payments cannot be guaranteed for more than 6 months after the time of such borrowing, the OASI cash flow problem <u>must</u> be resolved before July 1, 1983.

In an attempt to find a bi-partisan solution to these problems, President Reagan on December 16, 1981, appointed a 15-member National Commission on Social Security Reform. This rather high-powered group includes four Senators, three Representatives, two former Representatives, a former Commissioner of Social Security, the Chairman of the Prudential Insurance Company, and other prominent persons. Alan Greenspan is the Chairman and Bob Myers is Executive Director. The staff includes several SSA employees, including myself. At this point, the Commission is really just getting started. The first meeting was held on February 27, and no recommendations have been made yet. The report of the Commission is due on December 31, 1982, although the Senate Budget Committee urged, on May 6, that the report be issued by November 11.

The Congress is not sitting idly by while the Commission does its work. There was much recent discussion, although no action, in the Congress concerning modifications to the OASDI benefit increase, both the 7.4% increase that will occur next month and future increases. The general direction of these changes would be to reduce or to delay future benefit increases, but it seems that the election year realities simply precluded any agreement for now. President Reagan said earlier this month that the 7.4% increase in 1982 is guaranteed.

One bill, which got a lot of attention recently and has a reasonable probability of enactment, is the Disability Amendments of 1982, H.R. 6181, which would essentially liberalize the program in the sense that it would provide certain protections and special payments to beneficiaries affected by continuing disability investigations. The bill also includes several basically technical changes affecting the workers' compensation offset, as newly expanded. Another bill that may be introduced soon would prohibit organizations from opting out of Social Security coverage and would introduce a new method of computing benefits for persons with non-covered earnings so that they would not get the advantage that the weighted benefit formula provides to low-earning workers.

The more major changes on the horizon, of course, will depend to some extent on the recommendations of the National Commission. I do not expect to see anything really new, but rather certain choices will be made from the existing long list of well-discussed possibilities, including raising retirement age, universal coverage, modifications to cost-of-living increases, etc. The only thing known for certain is that some action must be taken within the next 12 months or so, and I am confident that this time, a fairly long-term solution, rather than a short-term stop-gap measure, will be the goal.

MR. WARREN R. LUCKNER: My role today is to discuss some of the current issues in OASDI from what I would call a "benefit design" perspective.

Having had some experience as an individual life product development actuary, I'd like to start my presentation by briefly discussing the considerations involved in designing a new product. Those are:

Legal - What are the legal implications? For the company? For the current and potential policyholders?

Equity - How can the change be accomplished so that there is equitable treatment of all policyholders - new and existing?

Objectives - What are the objectives the company wishes to achieve with the change?

Adequacy - What is an adequate charge to cover all the benefits and expenses associated with the change?

Competitiveness - How will the change affect competitiveness? With respect to cost? Product design? Other financial security vehicles?

Consistency - How will this change affect consistency in design, objectives, pricing, etc. within the portfolio of products offered?

Expenses - Are the expenses associated with the change at a reasonable rate?

Practicality - Is it practical to implement?

Time and Facilities - Is there sufficient staff time available? Are there adequate facilities available?

Simplicity - Can the change be kept simple and understandable?

Sometimes some of these considerations conflict with each other in terms of the type of action implied. Thus, the importance of each consideration must be prioritized for a given task. And, of course, not all of these considerations apply to the issue of the proper benefit design for OASDI. However, this list does give us a framework. My personal bias is that the three primary considerations for OASDI benefit design are: equity, objectives and adequacy. The equity issue is primarily one of fairness. And reasonable people can disagree over what is fair. The notion of fairness for a social insurance program is different from that for individual life insurance products because of the notion of social adequacy, which is tied to the question of the objectives of the social insurance program. Adequacy in this context has a somewhat different meaning than that usually associated with adequacy in a list of considerations for product development. In the latter context, the primary adequacy consideration is more analogous to the issues Dwight Bartlett discussed. In the social insurance content, adequacy also refers to the question of whether or not an adequate benefit level is achieved. The objectives of the social insurance program are of primary importance and to a certain extent the questions of equity and adequacy depend on what those objectives are. The objectives of a social insurance program may change over time due to external factors.

My personal opinion is that OASDI should primarily be a program to assure a minimum level of financial security for all workers or their beneficiaries in the event of premature death, disability or retirement, with a reasonable relationship between benefits provided and taxes paid. A secondary objective is the use of the program as a tool to help implement government policy with respect to individual financial security, retirement and taxation.

Now on to some issues.

TYPES OF BENEFITS

The first issue I wish to address is the types of benefits provided by the OASDI program. The obvious concern is whether the types of benefits provided are appropriate. Some believe the program has been expanded too much in this area and this expansion is contrary to the proper purpose of a social insurance program. As Bruce Schobel has indicated, 1981 legislation has impacted on the types of benefits provided. The net result is that mother's and father's benefits are terminated when no child under age 16 is present (except in the case of a disabled child age 16 or over), the phasing out of child college attendance benefits and restriction of child high-school-attendance benefits to those under age 19, and the lump-sum death benefit is available only for surviving spouse or eligible children (instead of for all deaths of insured workers). The second change causes me a bit of concern. It is becoming increasingly difficult to finance a college education and the need for such an education has not diminished. The continuation of benefits during college attendance provides an important incentive. With regard to the lump-sum death benefit, I would go further and eliminate it entirely. It is a minimal benefit and the need that it addresses is perhaps more properly met by individual or group insurance.

It is interesting to note that, according to the 1979 survey completed by Peter D. Hart and Associates for the National Commission on Social Security, the largest percentage of people (42%) felt that none of a list of 13 different kinds of Social Security benefits should be eliminated. The question asked was: Here are some specific types of benefits that are now being paid for from Social Security taxes. Are there any benefits listed here that you think should not be paid for at all by any government taxes?

Identified most often for elimination were benefits to full-time students whose parent has retired (40%), benefits to full-time students (18-21) whose parent has died (21%) or become disabled (19%) and benefits to children of retired workers (14%). The majority either identified none (42%) or were unsure (10%). It is interesting to note that the lump-sum death benefit was not addressed by the question.

The following table gives a detailed summary of the responses:

	ALL RESPONDENTS %	NON-RETIRED %	RETIRED HOUSEHOLD %
Number of respondents	(1549)	(1115)	(434)
Full-time students whose parent has retired	40	42	33
Full-time students (age 18-21) whose parent has died	21	22	21
Full-time students whose parent has become disabled	19	19	18
Children of retired workers	14	15	10
Wives of disabled workers with children	5	5	5
Wives of retired workers	5	6	3
Children of disabled workers	4	5	4
Hospital bills for people 65 and older (Medicare)	4	4	3
Hospital bills for disabled workers (Medicare)	3	4	2
Families with children of workers who die	3	2	3
Disabled workers	2	2	5
Retired workers	2	2	2
Retired widows	2	2	2
None (volunteered)	42	41	43
Not sure	10	8	14

BENEFIT LEVELS

The issue of benefit levels is a crucial one. It obviously has a critical impact on the financing of the system. The benefit levels, along with the population demographics, determine how much is going to be paid out. From a "benefit design" perspective, the concern is whether the levels are adequate in light of the purpose of the OASDI program. Throughout the history of the OASDI program, the benefits were described as providing a basic income, which together with other sources of income would provide for the basic needs and obligations of the beneficiaries.

One of the conclusions of the 1979 Hart survey was that this seems to be accepted by the American people as a description of the way the OASDI system works, but not the way the system should work.

The following tables provide the data that led to these conclusions:

Statement A: Social Security retirement benefits should provide enough money to meet the basic needs and obligations of retired people.

Statement B: Social Security retirement benefits should not by themselves provide enough money to meet all the basic needs and obligations of retired people, but should provide enough so that together with other sources of income retired people may have their basic needs and obligations met.

Which one of these statements do you think best describes the way the Social Security retirement benefits program actually works?

	ALL RESPONDENTS (1,549) %	ALL NON - RETIRED (1,115) %	ALL RETIRED (434) %
Statement A	22	21	26
Statement B	65	67	60
Neither (volunteered)	4	4	3
Not sure	9	8	11

Which comes closer to your view of what the program's purpose should be?

	ALL RESPONDENTS (1,549) %	ALL NON - RETIRED (1,115) %	ALL RETIRED (434) %
Statement A	61	63	56
Statement B	34	33	37
Neither (volunteered)	1	1	1
Not sure	4	3	6

On the other hand, it is interesting that a 1979 Harris survey, as reported in the second edition of Bob Myers' book, found that about 76% of those surveyed were in favor of OASDI providing only a floor of protection, with supplementation being necessary from other sources.

The benefit level adequacy concern is really two concerns. First, that the initial benefit is at an adequate level. Secondly, that the value of that benefit is not eroded during the payout period. The measure that has generally been used as a criteria for adequacy of the initial benefit is the replacement rate, that is, how do OASDI benefits compare to recent past earnings. This replacement rate indicates the extent to which the OASDI benefits enable beneficiaries to maintain a standard of living reasonably close to what the worker had achieved before benefits became payable. Given that the "floor of protection" concept is the proper one for OASDI (and not everyone will agree to this) the issue becomes: what is a "floor of protection" level for replacement rates? Because of the different tax situation, the elimination of work-related expenses and savings, it is not necessary to have 100% of the worker's earnings level replaced. In his text, Bob Myers presents an analysis of net replacement rates which leads to the conclusion that for retirement cases, OASDI benefits take care of the full economic needs of very low earners reasonably well, provide substantially for average earners and yield a floor of protection for upper-middle and high earners. The disability benefits, when eligible dependents are present, and the young-survivor benefits are at a relatively high level for all incomes, leaving little room for supplementation, except for high earners. In my opinion, the net replacement rates for OASDI are generally at a level that is a bit too high and could be reduced without undermining the initial benefit adequacy principle for OASDI. In this regard, some questions that develop are: How should the benefit formula be indexed? How should the wage base be indexed? What is a proper target for replacement rates?

For maintaining the adequacy of benefits during the payment period, currently the benefits are automatically indexed by the CPI. With the CPI increasing more rapidly than wages, there has been concern over whether OASDI beneficiaries (retirees in particular) should have the value of their benefits protected more from erosion than the value of workers' wages. Also, although there seems to be general agreement that benefits should be indexed, there is some debate over the proper index. As reported in the April 24, 1982 National Underwriter, Don Grubbs provided a thorough discussion of this indexing issue at the Houston meeting. He concluded that the CPI-U index (reflecting the entire urban population), with a new rental equivalence basis, appears to be the best available measure of real changes in the cost of living, and thus best measures the amount needed for retirees to maintain the same standard of living. Currently, CPI-W (reflecting the urban worker population) is used, but CPI-U is preferred because it includes retirees, while CPI-W does not. Mr. Grubbs also reported on some simulations of the impact of two proposals for modifying the cost-of-living adjustment for Social Security benefits. The studies, completed by Consumer Markets Service of Data Resources, Inc., indicate that

1. If there is no change in the cost-of-living adjustment by 1990, the number of people age 62 and over who are below the official poverty line, will have decreased to 3.7 million from 4.1 million in 1980.

2. If two-thirds of CPI is used, the number below the official poverty line will be 5 million.

3. If inflation less 3% is used, the number below the official poverty line will be 5.7 million.

There are others who believe the benefits during payout should be indexed by the increase in wages, since that is how the contributions increase. That argument has merit from the financial perspective but seems to ignore the question of proper benefit design.

In their paper "Constant Replacement Ratios in Retirement: A Theoretical Approach", Barnet Berin and Anthony Richter develop an approach for maintaining the combined Social Security and pensions replacement ratio. During the payout period, their method has the salary base increase and the Social Security increase already determined and the variable factor used to maintain the constant replacement ratio is the change in the private pension benefit.

To conclude this section I would just observe that I generally agree with the 1979 Advisory Council's statement of the following benefit principles:

1. There should be a balance between the goals of adequacy and equity. Low-wage earners should continue to get proportionately higher benefit than high-wage earners.

2. Workers who have a regular attachment at full-time employment covered by Social Security for at least 30 years should become entitled to a retirement benefit that at least keeps them out of poverty. Workers who earn more should receive more. Social Security cannot be expected to assure a benefit that exceeds the poverty level for workers who do not spend most of their working lifetimes under Social Security or who work only part-time during most of their careers.

Although it may be implicit in the above principles, I would add the principle that the adequacy of the initial benefit and the benefit during the payout period should be maintained over time.

EARNINGS TEST

The motivation for my writing the short paper on the OASDI earnings test was what appeared to be a lack of attention or reaction to the Reagan administration recommendation to phaseout the earnings test, which would, in my estimation, represent a fundamental change in the OASDI program. As Bruce Schobel indicated, the final legislation in 1981 simply delayed reduction of the exempt age.

The paper attempts to pull together all the arguments pro and con regarding the earnings test and categorize the arguments into one of the following categories: philosophical, financial (from the individual's standpoint as well as the system's), political and practical. I also felt the attitude of the general population should be considered, and was surprised to discover that the issue of the earnings test was not addressed in the nationwide survey of attitudes toward Social Security, commissioned by the National Commission on Social Security. I have prepared a couple of questions on the earnings test to be included in the 1982 Nebraska Annual Social Indicators Survey. The results should be available late this summer.

My conclusion is that the earnings test should be retained, primarily because of philosophical considerations. Other considerations (e.g., financial) also pointed me toward retention of the test. I did make some recommendations for improving the test, some of which might be considered controversial. My recommendations include:

1. That the test have the same exempt amount for all ages at the level currently in effect for beneficiaries aged 65 or over, and that the test apply uniformly at all ages.

2. That OASDI payroll taxes be deductible from gross income and that Social Security benefits be fully taxable.

This latter evolved during the development of the paper and, as one of the paper's discussants noted, is not directly related to the earnings test issue. As I studied the pros and cons of the earnings test, it occurred to me that the more fundamental issue of what OASDI payroll taxes represent was causing some of the difficulty with accepting the earnings test as a proper provision of the OASDI program. My motivation for the tax deductibility of OASDI contributions was a combination of several rather unscientific factors. First, I thought about the TIAA-CREF plan at the University and its tax-deferred status and reasoned that OASDI contributions might be considered similar, not because OASDI is a pension plan, but because it serves a similar purpose - providing retirement income. Secondly, I supported the taxing of OASDI benefits and did not feel it quite "fair" to tax benefits which were developed from contributions that came from fully taxable income. Thirdly, by providing tax deductibility, everyone gets some benefit from their OASDI contributions. Finally, I felt that the integenerational transfer for the purpose of providing some base of financial security for the elderly, disabled or survivors of the deceased certainly can be considered a charitable endeavor as much as some of those items currently qualifying for tax deductibility. At this point, I still philosophically support this deductibility-taxability proposal but recognize there are some potential implications that require further study. As one discussant suggested, deductibility may effectively be equivalent to supporting OASDI through general revenues. Also, does deductibility discriminate against those who save for their retirement?

RETIREMENT AGE

The issue of raising the minimum age for full retirement benefits has received a lot of attention lately. It makes sense logically and financially. With the changing demographics implying that around the turn of the century, there will be relatively more older people (e.g., over age 65) and relatively fewer younger people, and with decreasing mortality and improved health, it makes sense to encourage people to work longer. Financially, it obviously helps to delay payment of full benefits. From a benefit design perspective, it also makes sense that if age 65 was the "right" minimum retirement age in 1935, then it probably isn't the "right" minimum retirement age in 1982. Of course, it is true that age 65 was initially chosen as a compromise between 70, which seemed too high, and age 60 which was too costly. Still, it seems that an increase in the minimum age for full retirement benefits would be appropriate.

However, it should be noted that the 1979 Hart survey seemed to indicate a somewhat negative response to increasing the minimum retirement age as opposed to increasing Social Security taxes. All age groups seemed to oppose increasing the minimum retirement age. This is perhaps in part due to the trend toward early retirement. Although not completely shown in the following table, the strongest opposition comes from the more affluent, from those in the 35-64 age groups, and from blue collar workers, all of whom tend to find early retirement appealing.

> If it came to a choice between increasing Social Security taxes or in 20 years raising the age at which full retirement benefits are paid from 65 to 68 and raising the age for early benefits from 62 to 65, would you strongly favor, mildly favor, mildly oppose, or strongly oppose raising the age for retirement benefits?

	ALL RESPONDENTS (1,549)	AGE 18-24 (212)	25-34 (327)	35-44 (235)	45-54 (219)	55-64 (220)	65 & Over (331)
	%	%	%	%	%	%	%
Favor	36	37	43	32	34	28	38
Oppose	51	52	48	58	52	59	43
Not Sure	13	11	9	10	14	13	19

Of course, we should keep in mind that this survey is from 1979. Still, average retirement ages (both as reflected by OASDI statistics and as shown by the increasing pressure for early-retirement provision in private pension plans) have been steadily falling. This trend in retirement ages was discussed in detail this morning at the session covering Retirement Age Issues, Trends and Assumptions. Some feel that a change in this trend might occur in the next two decades, as labor-market shortages appear and health conditions improve. Also, the fear of continuing inflation may reverse the trend toward early retirement, although some comments made this morning indicated that the bad economy has actually increased early retirement (as opposed to being laid off). My own personal philosophy is that the ideal system would allow for freedom of choice and workers would not be severely penalized for either early retirement or late retirement. This, of course, precludes the government from using OASDI early or delayed retirement adjustments as a tool for encouraging or discouraging certain retirement patterns.

There are complicating factors to increasing the minimum retirement age for full benefits for OASDI. If the minimum age for full benefits is increased, what about the ages for which reduced benefits are available? And, how can such a change be coordinated with private pension plans?

The idea of a phased-in automatic increase according to changes in longevity, appeals to me, primarily because of its mostly objective nature. As Bob Myers points out in his text, this would not be too difficult to accomplish. However, the questions of reduced early retirement benefits, and coordination with private pension plans, are significant and require careful thought.

To conclude my prepared remarks I would like to make a few general, but what I consider very important, observations with regard to the national Commission on Social Security reform. I have some feelings similar to those I have heard expressed by others with respect to the forming of another group to study Social Security. First, the Commission must keep in mind that changes in the OASDI system may have a profound impact on the private pension system. Also, I am not sure what new territory will be covered by this Commission and what new proposals will be forthcoming. The final report of the National Commission on Social Security was published a little over a year ago. I am not sure the problems confronting the Social Security system have changed that much to warrant new study and proposals. On the other hand, this may be a new opportunity to consider the fundamental nature and purpose of a social insurance system and the form of such a system that can work best in a changing environment. Thus, I would encourage the Commission to consider not only modifications within the current structure, but also to consider alternative structures, such as that proposed by Haeworth Robertson in his book <u>The Coming Revolution in Social Security</u>.

Finally, I would encourage the Commission to keep in mind the "benefit design" aspects of any proposed changes. The financial aspect is obviously important, but we should not let those considerations modify the program in such a way that it fails to achieve its intended purpose.

MR. RALPH EDWARDS: I have submitted a written discussion of Warren Luckner's paper but one additional thought comes to mind. The effect of the Earnings Test, in practice, depends on how it is imposed. I do not know all the ins and outs, but I believe that there is a tendency for the Earnings Test to take the earnings of this year and reduce next year's OASDI benefit. Now, if that is how it works and you have a low paid individual working after retirement he is apt to spend his earnings when he gets them and next year he is going to have a reduced benefit when he has no earnings. I think that is a serious defect in the administration of the Earnings Test.

MR. LUCKNER: I appreciate those remarks. Theory and practice are different. I still support the Earnings Test, based on the arguments that have been presented in the paper. The actual implementation of this test may cause some problems. This is something which should be addressed by the Social Security Administration. For a particular individual with low earnings, his benefits may not be affected that much, if at all. This is because the exempt amount is at a reasonably high level and it is automatically changed each year.

MR. HICKMAN: The 1977 amendments eliminated the monthly earnings test, except in the first year that benefits are received, and imposed an annual test. The objective was to reduce the comparative advantage of persons with seasonal earned income. The annual test also has disadvantages.

MR. MARK NEWTON: Bruce, can you estimate for me the extent to which disability benefits will be reduced by the Social Security Administration's review of people on the roles?

MR. SCHOBEL: The periodic review process began in March 1981. In the 13 months ending with March 1982, the State agencies reviewed 343,115 cases, with 138,249 resulting in cessations. Unfortunately, those figures include "regular" medical diaries as well as periodic reviews, for which separate data did not become available until October. In addition, the cessation rate will probably decline somewhat in the future because SSA targeted the "high-risk" cases to be reviewed first.

MS. JANE CRISE: Mr. Bartlett, what do you think about having participation in Social Security be on a voluntary basis? Do you think this would be likely?

MR. BARTLETT: No, I don't think that it is very likely. I myself, would be opposed to that concept. It seems to me that the system is a balance between social adequacy and individual equity but that when there is a conflict between those two principles, the social adequacy consideration should be predominant. I think that has been a philosophy that has been in the system ever since the beginning. I don't see how you can have the emphasis on social adequacy that we have in the system and have it on a voluntary basis. It is like trying to run an old fashioned assessment company. It would fall of its own weight, in the long run, if it were put on a basis which emphasizes social adequacy while giving people an option of being in or out.

MR. HICKMAN: The system is redistributive. It redistributes income like Robin Hood, from the rich to the poor. The most persuasive single reason for making the system universal is that if you have a redistributive system, everybody should be included.

MS. CRISE: I take it from your comments that you view OASDI more as a type of welfare program than as an insurance program?

MR. BARTLETT: It is a social insurance program. It is an insurance program which emphasizes social adequacy.

MR. BRUCE GOLD: Recently the IRS clarified regulations concerning Section 401(k) of the Internal Revenue Code. It seems that you can use Section 401(k) to defer income and that this income would not be taxed for Social Security purposes. This is a loophole because you only receive a 15% benefit for your marginal earnings. The Social Security benefit formula uses the following percentages: 90%, 32%, and 15%. Is there anything in the works to try and remove this loophole?

MR. SCHOBEL: I don't know of anyone who has looked at this particular item. But, I think that as a general statement the percentage of total compensation that is taxable for Social Security purposes and also income tax purposes too, for that matter, has been dropping over the years. I think that sooner or later the Congress is going to say no. We just can't let our tax base erode year after year after year. We saw one example of this last year in taxing sick pay. It used to be tax free. Now it is taxed and I think that eventually, say 10 years or maybe 20 years, you will see a lot more of these things taxed. I think that as these loopholes appear, the Congress removes them. A good example is FICA II where the employer pays the tax for the employee and was able to save a tiny portion of the Social Security tax. If you have 100 employees, it could amount to about $10,000 to $20,000 a year. The Congress essentially closed that with a transition period and with some exceptions in 1980. I think that they are going to close more and more of these.

MR. GOLD: Assuming that they can't raise the present tax level, say by the middle of 1983, are they going to end up dipping into general revenue so that in effect there would be an unseen FICA tax, i.e., part of my income tax would in effect be going to pay FICA taxes.

MR. SCHOBEL: They are going to have to do something and General Revenue is a distinct possibility.

MR. GOLD: Let's say that in the future the taxes are taken out of general revenue, so that everyone pays for Social Security even though they have opted out. Will they be prohibited from receiving credit?

MR. SCHOBEL: You are asking me a question that can't be answered. If the Congress were to change the system, in such a fundamental way as to have general revenue financing, they would have to change an awful lot of things. They would have to think about covering all federal workers, for example who are not covered. Why should they have to pay part of the cost of the program?

MR. GOLD: One of the arguments I have heard against opting out of Social Security is that if they ever go to general revenue financing and you have opted out, you will not receive any benefits while paying for the benefits received by others who have not opted out.

MR. HICKMAN: I don't think anyone could answer that question because it involves possible future legislation.