RECORD OF SOCIETY OF ACTUARIES
1983 VOL. 9 NO. 2

CURRENT DEVELOPMENTS IN SOCIAL SECURITY

Moderator: H. ROBERT EPLEY, III. Panelists: BRUCE D. SCHOBEL, JAMES R. SWENSON, HOWARD YOUNG. Recorder: JAMES G. PEARD

As a result of the report of the National Commission on Social Security Reform issued in January 1983 and the likelihood of major Social Security legislation at about the time of the meeting, this session is expanded to cover the broader issues developing in Social Security in addition to the opting out issue.

MR. H. ROBERT EPLEY, III: Last Fall when the preliminary program for these Spring meetings was set up, the subject of opting out of Social Security was a very active issue with state and municipal governments and nonprofit organizations. The Program Committee of the Society was responsive and included a workshop on the subject.

Since then, the National Commission on Social Security Reform sent its report and recommendations to the President and the Congress on January 20, and bills H.R.1900 and S.1 were introduced in the House and Senate, respectively. Each of these bills went through Committee and each body passed a version of the bill. A Conference Committee resolved the differences between these two bills and, on March 24 and 25, 1983, Social Security legislation was approved by both sides of Congress. Just two weeks ago, President Reagan signed the Social Security Amendments of 1983 into law (Public Law 98-21). One more item of importance has also occurred -- the Program Committee has shown their ability to react quickly to change. The workshop on Opting Out of Social Security has been updated and expanded to this Open Forum session on Current Developments in Social Security.

Those of us in this room today are fortunate -- major legislation that will affect each and every one of us personally, and many of us in our businesses, became law only two weeks ago and here we are now with the opportunity to hear about the provisions of the law, how these provisions could affect us, some background on how the whole process developed and, possibly, where the legislation may have fallen short (or, in other words, where do we go from here).

Let me introduce you to the panelists in the order in which they will be speaking. Bruce Schobel is an Actuary with the Social Security Administration but, in all honesty, hasn't spent much time there in the last year or more. From January 1982 through January 1983, Bruce was a staff member to Bob Myers, Executive Director for the National Commission. For a two month period since then, he was on special assignment to the House Ways and Means Committee involved in the development of H.R.1900. Let's welcome Bruce back to Social Security Administration so he can help interpret and implement the new amendments.

Jim Swenson is also an actuary and a Vice President with Prudential Insurance Company. He was the staff assistant to Commissioner Robert Beck while he was a member of the National Commission on Social Security Reform. Because of that responsibility, Jim has kept his finger on the pulse of Social Security these past months and will offer some interesting insights in these recent developments.

Howard Young is Special Consultant to the President of the United Auto Workers Union in Detroit. In addition, he is the Director of the UAW Social Security Department. Howard was a staff assistant for Commissioner Robert Ball while he was on the National Commission. Howard was also the speaker of the New Fellow's Luncheon this past hour, so we will give him a breather and let him have the last word.

I believe I could say that Jim will present the more conservative viewpoint and Howard the liberal side. We should all be treated to an interesting and informative afternoon.

MR. BRUCE D. SCHOBEL: The financing problems of the Social Security system have been in the news for almost a decade. In the short range, benefit outgo has been increasing faster than has tax income, thus causing the trust fund balances to decline. For several years, the Old-Age and Survivors Insurance and Disability Insurance Trust Funds had been expected to become insufficient to pay timely benefits sometime in the early 1980's. The Hospital Insurance fund was expected to have similar problems but not until later. In the long range, all three funds--OASI, DI, and HI--were expected to have severe problems.

The enactment of the Social Security Amendments of 1977 was the first major attempt to resolve these problems. On signing this bill, President Carter stated that it would reassure both beneficiaries and workers "that the Social Security system will be financially sound well into the next century." Unfortunately, this prediction was not accurate. The very unfavorable and unexpected economic condition of the late 1970's and early 1980's caused the continued deterioration of the financial condition of the Social Security system.

Several fairly significant laws, including the Disability Amendments of 1980 and the Omnibus Budget Reconciliation Act of 1981, served to delay the expected "bankruptcy" of the Old-Age and Survivors Insurance fund until sometime in 1982. Inter-fund borrowing from the healthier Disability Insurance and Hospital Insurance funds would delay this inability to pay timely benefits until sometime in 1983 or 1984, but such borrowing was not permitted under the law at that time.

In December 1981, President Reagan signed a law permitting limited interfund borrowing. The OASI fund could borrow from either the DI or HI funds, but only to the extent necessary to guarantee benefit payments in the first six months of 1983. Thus, the inevitable financing crisis was assigned a precise date--July 1, 1983--when the OASI Trust Fund would not have sufficient assets to allow the Treasury to send out benefit checks.

On September 24, 1981, President Reagan announced his intention to appoint a bi-partisan National Commission on Social Security Reform, which was appointed on December 16, 1981. This Commission, consisting of eight Republicans and seven Democrats, and chaired by Alan Greenspan, met several times during 1982 and finally, after receiving a last-minute extension of its December 31 reporting date, reached an agreement on January 15 of this year. That agreement formed the basis of the recently enacted Social Security Amendments of 1983 (Public Law 98-21), which was signed by President Reagan on April 20.

The Social Security Amendments of 1983 provide sufficient financing to resolve the short-range financing problems of the OASDI system, even under fairly pessimistic conditions. The law also includes several changes that are effective only in the long term (1990 and later), and the combined effects of the short-range and long-range elements are sufficient to eliminate the estimated long-range deficit of 2.1 percent of taxable payroll (under intermediate II-B assumptions).

The short-range changes raise a total of $166 billion over the period 1983-89. These changes can be divided into five categories: coverage ($25 billion), benefit changes ($38 billion), payroll-tax increases ($59 billion), taxation of benefits ($27 billion), and other changes ($18 billion).

The major coverage changes are the mandatory coverage after 1983 of new Federal hires and of all employees of non-profit organizations. In addition, those State and local governmental units which are now covered are prohibited from terminating coverage, and those units which had terminated coverage are permitted to rejoin the Social Security system.

By far the largest element in the category of benefit changes is a 6-month delay in the cost-of-living-adjustment (COLA) from July to January, which saves an estimated $39 billion. This is a permanent change, not just a one-time deferral. Also included are several modifications which increase benefits for certain divorced or disabled spouses and surviving spouses. One provision will reduce so-called windfall benefits to some workers with pensions based on non-covered employment; another will essentially increase the benefits of some auxiliary and survivor beneficiaries with such non-covered pensions by reducing the amount of offset.

Increases in the payroll-tax rates had been scheduled in previous law for 1985, 1986 (for HI only), and 1990. The 1983 amendments advance the 1985 increase to 1984, although the increase for employees is provided through a general-revenue transfer, and about three-fourths of the 1990 increase is advanced to 1988. These payroll-tax increases on wage-earners will raise $39 billion.

The self-employed will also pay higher Social Security taxes. In the past, the self-employed paid about three-fourths of the combined employee-employer tax rate for OASDI and one-half of the combined tax rate for HI. The 1983 amendments will raise the self-employed tax rate to the full employee-employer rate in both cases; however, these increases will be partially offset by income-tax credits during 1984-89. After 1989, the net earnings of self-employed workers will be adjusted so as to exclude half of the SECA tax, thus making their tax treatment equivalent to that of employees. These changes in the tax rates for the self-employed will increase OASDI revenues by $19 billion in 1984-89.

One provision in the 1983 amendments which will not raise a large amount of additional income, but which is attracting considerable attention, requires that contributions to certain tax-sheltered employee retirement-savings arrangements must be included in income for purposes of computing Social Security taxes and benefits. The income-tax treatment of such contributions is not affected. Therefore, these plans would be treated like IRA's, with income taxation being deferred but Social Security taxation being immediate. The problem with previous law was that some of these arrangements were able to escape Social Security tax altogether.

This provision indicates the continuing concern of Congress in preventing erosion of the Social Security tax base. Although the tax-sheltered nature of these plans was not resulting in large revenue losses to the OASDI system under previous law, the potential loss if such plans were widely adopted was enormous. The Congress has demonstrated several times in recent years that they are unwilling to tolerate "loopholes" that would permit significant amounts of employee compensation to escape the Social Security tax.

All Social Security benefits have been tax-free under previous law. Beginning in 1984, however, a new tax will be payable if the sum of adjusted gross income, tax-free income, and one-half of Social Security benefits exceeds $25,000 for single individuals and $32,000 for married couples filing jointly. In such cases, the taxpayer will be required to include in taxable income the lesser of one-half of the Social Security benefits or one-half of the excess income (including half the Social Security benefits) over the threshold amount. In no case will more than one-half of the Social Security benefits be includible.

The additional income taxes collected as a result of this provision will be transferred (in advance) from the general fund of the U.S. Treasury to the OASDI Trust Funds. This transfer is therefore regarded by some as a general-revenue subsidy to Social Security. Others consider the taxation of benefits to be simply a new tax, and still others regard it as a benefit "recapture", because the net effect is a reduction in the benefits of high-income persons. Because of the controversial character of this provision, it is considered separately in this presentation.

The final category of changes consists mainly of two items--a modification to the financing basis of certain military-service wage credits and crediting of past and future uncashed benefit checks to the OASDI Trust Funds. The first item will result in net transfers of $16 billion in 1983-89 from the general fund of the Treasury to the OASDI funds; the second will result in similar transfers of about $2 billion.

The 1983 amendments include four financing provisions for which no cost effect is shown. First, the Treasury will now credit the estimated Social Security tax revenues in each month on the first day of the month. In that way, the funds are available when needed to provide the benefit payments, which go out normally on the third day of each month. This provision does not provide any additional net revenue, but it does improve the timing of the cash-flow for the OASDI system.

The second provision extends the inter-fund borrowing authority among the OASI, DI, and HI Trust Funds through 1987 (it had expired at the end of 1982). This provision also sets certain restrictions on when inter-fund loans can occur, and it specifies a repayment schedule under which all such loans must be repaid by the end of 1989.

The other two provisions are effective only if the trust-fund reserve level drops below certain limits. In that case, the annual cost-of-living adjustment percentage may be reduced to the percentage increase in covered wages, if that percentage is lower than the increase in the CPI (which normally is used). If the trust-fund ratio later increases sufficiently, these reductions in COLA's are paid back. The last provision requires the Board of Trustees to develop and transmit to the Congress a plan to modify the financing of the Social Security system if they determine that all of the preceding measures are inadequate to maintain a trust-fund ratio of at least 20 percent.

The net effect of all of the preceding changes on the short-range financial situation of the OASDI system obviously depends on the economic assumptions chosen. Under extremely pessimistic assumptions--for example, under conditions as bad as those experienced in 1979-81--the OASDI system could still become unable to make timely benefit payments sometime in the late 1980's. Under the intermediate (alternative II-B) assumptions developed for the 1983 Trustees Report, however, the OASDI Trust Funds will grow steadily from $25 billion at the beginning of 1983 (including loans from the HI Trust Fund) to $114 billion at the beginning of 1990 (at which point all of the loans from HI will have been repaid). The OASDI trust-fund ratio will increase during the same period from 14 percent to 39 percent. Even under the pessimistic (alternative III) assumptions, the trust-fund ratio reaches 29 percent at the beginning of 1990, although it dips as low as 16 percent at the beginning of 1988.

None of these projections includes the estimated future experience of the HI program, for several reasons. First, most of the very significant changes in HI that were enacted in TEFRA in 1982 are only temporary, although they may be extended. Second, the effects of the prospective-payment provision that is included in the 1983 amendments cannot be determined very accurately until certain implementing regulations are issued. Third, the quadrennial Social Security Advisory Council that was appointed last year has been directed to focus its investigation on the Medicare program, and the resulting recommendations will certainly have some effect on future legislation. The projections under present law, however, show that without significant changes in either the law or the regulations, the HI Trust Fund will be bankrupt sometime in the early 1990's.

Before enactment of the 1983 amendments, the long-range (75-year) actuarial deficit of the OASDI program was estimated at 2.1 percent of taxable payroll under the intermediate (alternative II-B) assumptions. The provisions already discussed eliminate about 1.5 percent of this 2.1 percent deficit, and additional provisions that are effective only in the long range eliminate the rest. For purposes of analyzing the long-range effects, all of the provisions can be grouped into four categories: coverage, benefit changes, tax increases, and taxation of benefits.

The coverage extensions, all of which were described previously, provide additional long-range financing of about .4 percent of payroll. This additional financing is the net effect of increased tax income offset by additional benefit payments. It should be noted that, historically, most persons who engaged in non-covered employment at some time have obtained Social Security coverage through other, covered employment. For such workers, the additional taxes that will be paid as a result of this coverage extension will far exceed the additional benefits that will be payable. Therefore, there is a significant net gain to the system.

The benefit changes provide .8 percent of taxable payroll in the long range. This consists of .2 percent from the provisions mentioned previously and .6 percent from two long-range provisions. Beginning in 1990 (for those persons born in 1925 and later), the increase applicable to persons who delay retirement beyond the normal retirement age will be gradually raised from the present 3 percent for each year to 8 percent. This provision which has a cost of .1 percent of payroll, will be fully effective in 2008 (for those born in 1943 and later).

The much more significant long-range change, which will save .7 percent of payroll, is a gradual increase in the normal retirement age, in two stages, during 2000-2027. Nobody born before 1938 is affected by this provision. In addition, the earliest possible retirement age will remain at 62, although the actuarial reduction factor applicable at that age will increase from 20 percent to 30 percent.

Taxing benefits is another very significant long-range item, which is expected to reduce the long-range deficit by .6 percent of taxable payroll. The main reason that the anticipated savings are so large is that the $25,000 and $32,000 threshold amounts are not indexed. Thus, as time goes by, an increasing percentage of beneficiaries will find that some portion of their benefits is taxable. It is quite possible that these thresholds will be raised at some time during the 75-year long-range valuation period; thus, the estimated savings may be somewhat overstated.

In summary, the Social Security Amendments of 1983 should go a long way toward restoring the public confidence in the Social Security system. Unless economic conditions become much worse than they are today, the system should be solvent for at least 30 years and perhaps longer. Although the long-range situation is impossible to predict with the same level of confidence, we believe that the previous deficit of 2.1 percent of taxable payroll is essentially eliminated. Most important, the Congress has demonstrated its willingness to make some very basic changes in the structure of the system, and that willingness to change is the best indication that the system will always be viable, although perhaps not in exactly the same form it has today.

MR. JAMES R. SWENSON: I would like to begin by extending public congratulations both to the National Commission and to our legislators for enacting what I would characterize as generally responsible Social Security legislation. There were no easy solutions to the problems that confronted the legislators. The solutions that were enacted spread the burden as broadly as possible against all interest groups and the fact that every interest group complained about their share of the burden is probably an indication that the National Commission and our legislators did strike a balance. I personally hope that this bi-partisan approach to this very difficult political challenge can serve as a model for other difficult issues.

As Bruce mentioned to you, there are several major elements of the legislation. First, while there was an increase in payroll taxes, I would characterize it as a relatively moderate acceleration of future scheduled payroll tax increases. I characterize it as moderate in comparison to what was done in 1977. In 1977 our Congress enacted legislation which required taxpayers to pay $300 billion more than had previously been scheduled for the period of 1983 to 1989. The 1983 legislation raises $39 billion over the same period.

Second, coverage was expanded. As Bruce indicated, all non-profit groups will be required to participate, including those that opted out of the program. For those of you who are consulting actuaries, there should be some opportunities for groups seeking good actuarial advice.

Third, there were two important COLA changes that Bruce mentioned -- the 6-month COLA delay and the COLA stabilizer. I view the COLA stabilizer as the more important of the two COLA changes. If average real wages do not increase, then benefits will be limited to the average wage increases when trust fund ratios are low. As you recall, in 1977 Congress claimed to have solved the problems of Social Security until well into the 21st century. They would have, had there been any kind of break in the economy since 1977. However, during the past four years the cost of living as measured by the faulty CPI rose 35% faster than wages. As a consequence, benefits rose 35% faster than wages. If benefits had risen at the same rate as wages, the program would now be generating surpluses. There would not have been any short-term problem, at least for the OASDI program.

Fourth, up to half the benefits of higher income recipients will be taxed.

Fifth, there was a gradual increase in the normal retirement age. That is a demographic solution to a demographic problem.

What are the implications of these changes for private pension plans? The precise implications are a bit uncertain at this time since Congress and the regulators have to address a few issues. For example, the normal retirement age for Social Security has been gradually increased, however ERISA does not currently permit normal retirement beyond the age of 65. Assuming that our legislators amend ERISA to permit the normal retirement age to rise in conjunction with the normal retirement under Social Security, plan sponsors would then have to decide whether to increase their normal retirement ages. One fact that both management and labor should consider when making the decision regarding retirement ages is demographics and its effect on labor supply.

Demographics are responsible, at least in large part, for many of our current unemployment problems. There have been massive numbers of "baby boomers" who have entered the labor force during the past couple of decades. In addition, females have entered the labor force in an unprecedented manner. Once the "baby bust" generation begins to reach labor age, we will experience a period where the labor force supply will be relatively stable. Then, when the "baby boomers" reach retirement age, our nation will begin to be faced with labor shortages. At that time, it would be in the interest of business, labor and the economy to encourage older workers to remain on the job. They will be needed to produce goods and services. Therefore, while demographics have made it possible, and in many cases advantageous, for both business and labor to provide very generous early retirement features in their present retirement plans, I believe that those same demographics dictate serious consideration for an increase in normal retirement ages.

There are a couple of other issues which need to be taken into account when considering retirement ages. One is the effect that the recent laws had on Social Security integration. It is a grey area at the moment. However, the effect of the legislation is to reduce the benefits which are payable at age 65 even though the PIA amount and formula were unchanged. Plans with an offset provision will probably be required to fund to a higher private plan benefit level unless they make changes in their normal retirement age.

Another factor to be considered is that many plan sponsors set their benefit levels where the net, after-tax income from both their private plan and from Social Security replaces a relatively high percentage of before retirement, net income for career service employees. Social Security benefits, at least one-half of those benefits, will be subjected to income taxation for the first time. Initially, fewer than 10% of the beneficiaries will be affected. However, the income thresholds are not indexed and that was intentional. Eventually a large portion of future beneficiaries will be required to pay income taxes on half of their benefits. As a consequence, plan sponsors may wish to consider increasing their benefit levels under their private plans or they may wish to adopt an additional plan, such as a 401(k) plan, to compensate for the reduction in net Social Security benefits.

Future Social Security legislation will also have an impact on private plans. I view 1983 legislation as Round Four of Social Security legislation. The first round occurred in 1977 when the program was decoupled and there was a moderate reduction in future benefit levels. Round Two reduced the benefit level in the disability program. Round Three occurred in 1981 -- it included moderate changes to prospectively reduce the minimum benefit and to eliminate some of the student benefits. I think there will be more changes to modify the Social Security program.

For example, while the COLA modifications were significant, I would characterize them as relatively modest. I believe that additional changes to the Social Security COLA will be made.

If our nation is ever to regain control of its fiscal policies, it must face up to the issue of indexation, both on the revenue side and on the expenditure side. Our deficits are totally unacceptable. They serve as a major drag on the economy. They absorb savings, raise interest rates and serve as a major psychological deterrent to long-term capital expansion. Our legislators have little control over these deficits since so much of our current budget on both sides is indexed to CPI. You might say that we are locked into these large deficits until Congress faces up to the issue. I believe that they will have to come to that realization.

To be fair, Congress should address the indexation issue on both sides of the equation. Some have suggested elimination of indexation only on the tax side. Taxpayers would consider that a relatively outrageous proposal unless it is done on the expenditure side as well. It should be realized that Social Security is the major indexed expenditure, now exceeding 25% of all Federal spending.

There were two proposals advocated by the bi-partisan appeal led by Peter Peterson that deserve serious consideration. One is to index everything to the average of negotiated wage COLA's, roughly 60% of the CPI. Marty

Feldstein has proposed indexing everything to the CPI minus 2 or 3%. If you make the assumption that the COLA for Social Security will be modified, there will be more pressure to increase the benefits under private pension plans. The Canadian business community is already beginning to receive tremendous pressure to adopt more formalized indexation procedures under their pension plans.

On another front, as Bruce mentioned, Congress will be faced with an even larger problem -- Medicare. The problems of Medicare are caused by many of the same factors that created the problems for the OASDI program. Mainly, for the short term, poor economic conditions; for the long term, adverse demographics. However, they are also caused by the fact that health care costs have risen much more rapidly than either wages or prices for several decades and there is no end in sight. Despite massive cost shifts which have already occurred under the Medicare program, which merely represent an indirect form of taxes, the Hospital Insurance program is projected to go bankrupt sometime between 1986 and 1990. The Congressional Budget Office projects a deficit of $300 billion by 1995, even considering the recent legislation. Prior to that legislation, the actuaries within the Health Care Financing Administration were projecting a long-term deficit for the HI program of roughly three times the OASDI deficit. The present value of that deficit was $5.2 trillion.

Legislative action will soon be required. There is an Advisory Council studying the problem, and they will be issuing their report this summer. Whatever is done will have to address the problem of health care costs. However, even if those costs are miraculously controlled, Congress will still be confronted with a problem for which there are nothing but difficult choices for solutions.

Since we have stretched the level of tolerance for Social Security payroll taxes and because it is obvious that there are no general revenues available, only general deficits, a gradual reduction in OASDI benefits will probably be required to help financially support Medicare benefits, unless one believes the Medicare program is going to become means tested. I frankly do not believe that it will be. I am not certain what form the change will take. Certainly, an adoption of one of the indexation proposals I mentioned previously would be of assistance, but it will also be necessary to either gradually reduce the OASDI benefit levels or to adopt additional retirement age changes.

This will create additional pressure to increase the role of private pension plans. President Carter's Commission on Pension Policy was right when they concluded that our nation must gradually reduce its reliance on pay-as-you-go funded programs and increase our reliance on advance funded programs such as private pension plans and individual savings. The challenge is clear -- we must make certain that private pension plan sponsors address that challenge.

I am quite optimistic that those plan sponsors will meet the challenge assuming that we get the appropriate responses from our legislators. There was bi-partisan agreement among the experts who testified before the Commission that those over age 65 are now financially as well off as those under age 65. Among those over 65, the per capita income actually exceeds the per capita income of the rest of the population.

We are starting from a good base, and this has occurred despite the fact that private pension plans are still maturing. The number of private pension plans has continued to grow despite ERISA. There was a period of a couple of years where there was little growth. However, since ERISA, there has been a 10% growth rate in the number of plans per year and hopefully they will overcome the difficulties that TEFRA just recently brought. Shortly after the turn of the century, the Employee Benefit Research Institute has projected that more than 80% of new elderly households will receive private pension plan income. That is a considerably higher percentage than are now receiving pension income.

Furthermore, Americans do respond to individual incentives to save. The incidence of home ownership is a good example. Our tax structure has long encouraged home ownership and Americans have responded. Among those over age 65, more than 70% live in their own homes and more than 80% of those homes are mortgage free. IRA's are also in their infancy and early results have exceeded expectations. Thrift plan experience gives another indication that if Americans are given a little incentive for saving, they will respond. For example, at Prudential we have a thrift plan that provides a 100% employer match for contributions up to 3% of pay. While it is no great shock that 90% participate, it is noteworthy that with little incentive, other than for the deferral of taxation on investment earnings, two-thirds of those participating contribute more than the 3% amount that the employer matches, and the aggregate savings rate exceeds 10% at all income levels except for those whose incomes fall below $10,000 per year, where the savings rate was still a very respectable 9.6%.

It is important that we do not lose sight of the fact that individual mechanisms are not the panacea to the problem as some have suggested. You need both group mechanisms, which are the private pension plans, and the individual mechanisms. But because of the fact that there are those opportunities available, I am quite optimistic that our country will be able to gradually increase its reliance on advance funded private pensions and individual savings. These funded programs create the capital needed to foster economic expansion.

My major concern is that our legislators will take short-sighted actions to reduce the incentives for those programs because of our current deficits. This is what occurred last year with TEFRA. It also reduced some of the incentives for sponsors to establish, maintain and enhance their pension plans. The tax cap on health insurance benefits is additional evidence that legislators are looking at fringe benefits very carefully.

It is now more important than ever to expand the incentives for private retirement income rather than reduce those incentives. It is important that we make certain our legislators are aware of those concerns and we must make certain that we encourage plan sponsors to adopt benefit programs that are responsive to the need for additional private retirement income. Given the appropriate incentives and given the appropriate responses from business and labor, I am quite confident that all Americans can look forward to an adequate and secure retirement income.

MR. HOWARD YOUNG: I find it hard to disagree with Jim's analysis of what is important. It is just that I come up with all kinds of different answers.

Let me put a few things in perspective. Bruce told us that the short term problem was essentially solved with legislation that changes the financial balance -- whether revenue income or expenditure outgo -- between 1983 and 1990, by about $166 billion, or roughly $24 billion a year. That was the magnitude of the problem presumably that we had to solve. People told us that it could not be done with general revenue financing and that there was not that much revenue available. Yet we are encouraging IRA savings which probably last year cost revenue on the order of $15 billion. The final return is not in yet, but if we had $50 billion put away in IRA plans and at an average marginal tax rate of 30%, you would have $15 billion a year. If you had what I suppose might be the Utopia: 100 million workers in this country each putting away an average of $1,000 a year, or $100 billion into IRA's and if the average marginal tax rate was 24%, we would be spending $24 billion a year to subsidize IRA's. That is almost what it took to rescue Social Security in the short run, and I suggest that IRA's will not generate much more savings than would have occurred otherwise. That is what we found out with the All Savers programs.

So I do not buy the argument that we did not have the money to solve the problems or that we will not have it in the future.

Jim referred to three rounds of changes. Actually this is round four. There was a round in the early 1970's when automatic adjustment was first legislated. Automatic adjustment, for those of you who do not remember the history, was to save the system from fiddling around by the Congress. Until then the Congress had always been "too generous" and given away too much money whenever it changed the benefits. Therefore automatic adjustment was to insulate the program from political pressures. (I hate to admit that I am old enough to have been there to argue about it.) Some of us argued against automatic adjustment because it should be on the basis of wages rather than CPI, so the retirees could share in growth in the standard of living.

Now, we are told that if we had used indexing by wages, everybody would have been better off. But even that is not being proposed; instead people are supposed to get the lesser of the CPI or indexing by wages, which means that they get the worst of all possible worlds. Pretty unfortunate treatment for such a rich society. Also it is kind of unfair, but I think Jim said "that faulty CPI". This year the CPI was "corrected" and it is going up faster than if we had stayed with the "faulty CPI." This new CPI (not used for Social Security yet, but published every month -- the CPI-U as it is called) reflects rental income instead of mortgage payments. This is what the argument was all about last year, and the CPI-U is going up faster than the old CPI.

Returning to the recent Commission, there was not much debate about what was likely to happen to the Trust Funds or about feasible ways to technically deal with it. The debate was a matter of value judgements on how to deal with that, and the way we reconcile conflicts of value judgments is with political decision making. That is what politics, in the truest sense of the word, is all about. Also, we tend to overestimate the extent by which it does not happen in the private sector, because in the private sector it gets done in private and in the public sector it is done in a fish bowl. But if you have debated with your bosses or with your equals within your companies or otherwise, you know that things get thrashed out not always on technical terms but because people have different views how things should be handled.

I think political action was the proper way to deal with the problem, and it did come up with an answer that everybody agreed to live with considering the circumstances.

Also, I was going to say a couple of kind words about the Social Security Administration; Bruce made that unnecessary. He demonstrates the kind of people that we have in the Social Security Administration, and we are really very lucky to have them. I think that it is a very well run organization. They are extremely cooperative when you ask them for information. If any of you have not learned enough about Social Security by the time this session is over, just take the trouble to ask them -- they really will give you the answers that you want to know. They are very free with their numbers and they are really very good about being cooperative.

I would like to emphasize that the COLA delay is not a one-time delay. It is a 6-month delay every single year. Every single year retirees will get their COLA increase 6 months later than they otherwise would have. While it is not cumulative,the amount of increment will be 6 months less than it otherwise would have been. That is obviously how the savings get as big as they do. Retirees as a group made, or had imposed upon them, a significant and ongoing contribution to solving the problem.

I have spoken in too many Society meetings about my view on age retirement to bore you with it again. I can say that I think it was unnecessary to raise the retirement age. I think that the country could afford continuation of the current provisions. It will be very interesting if, as a result of having raised the retirement age under Social Security, we now see over the next year or two larger amounts of money going into private pension plans. This will in turn mean larger tax deductions and less revenue to the Federal Treasury. We will end up backing into the problem that we were supposed to solve in the first place, at least in the short run.

I will close on this note. I think that it is wrong to look at privatizing the Social Security system. I noticed that there is a conference scheduled for June by the Cato Institute, which is not the most liberal institute around. The basic theme starts with privatizing the system, or its equivalent, turning the system into more of an equity or individual account kind of a concept. The Social Security system is the most effective, and the most efficient, way to provide widespread retirement income in this country. What the Congress did in this legislation, including the normalization of contributions, is to prove what many of us have been saying all along, "When you take your Social Security check to the bank it isn't going to bounce." Thank you very much.

MR. JAMES L. COWEN: There is one thing that I would like to bring out. Although this legislation may have helped solve the problems of Social Security, it has created problems for other systems. The Civil Service retirement system will run into very severe cash flow problems as a result of this legislation. Similarly, the legislation did not determine a supplemental plan for new federal workers. The anti-cutback rules of ERISA were not addressed with respect to non-profit organizations, which are being brought in under Social Security. There is one question that I would like to ask regarding the delay in the COLA's. Has the base for determining the COLA's been changed from the first quarter to the third quarter?

MR. SCHOBEL: Yes. The December, 1984 increase will be based on the third quarter of 1983 to the third quarter of 1984 and therefore the period from the first quarter of 1983 to the third quarter of 1983 is permanently lost.

MR. COWEN: So the retirees have been affected permanently. I also take exception to using the word "stabilizer" for the changes that result in using the lesser of the increase in wages or the CPI. That will be a stabilizer if wages go up slower than the CPI. Otherwise it has no effect. The only true stabilizer is full employment.

Jim Swenson said the demographics after the turn of the century show us with a labor shortage. That will depend on technological changes that take place between now and then. With robotization, I am not sure we are going to have a labor shortage.

MR. SWENSON: I would like to comment on several issues. First, I agree technological changes could have a major impact and negate the projected unfavorable demographics.

Second, the stabilizer is referred to as a stabilizer in the law and also by the Commission.

I did some calculations which looked at the economic conditions following the enactment of the 1977 amendments in comparison with the projections that were made at that time. You made reference to the fact that what we need now is full employment. Those amendments were made under economic forecasts which predicted very high levels of employment. In looking at what happened, the trust funds lost approximately $32 billion because employment was not as favorable as the best estimate projections. However, they lost $84 billion due to real wage gains being less favorable than forecast in 1977. We did not have real wage gains, we had real wage losses. That cost the program over two times what unemployment cost the program.

The Civil Service program is really pay-as-you-go like Social Security even though there are some funds. The funds are invested in government securities and are promises by future taxpayers to pay the benefits. You are right that contributions by new federal employees will fund another pay-as-you-go system, Social Security, rather than the pay-as-you-go Civil Service plan. Bruce indicates that we don't know that for sure. And I do not believe that new employees are going to be required to pay the 7% contribution to Civil Service in addition to the contribution required to the Social Security program.

Finally, with respect to a point that Howard made about privatizing the system, I would like to indicate that Bob Beth does not believe that the system should be privatized. In fact, we believe there is a critical role for Social Security. We also believe that it is perfectly proper for a social insurance program to have a social adequacy tilt that favors low wage earners, and there need not be individual equity within the program. Really, questions Howard and I would debate are what is the proper role and what is the proper floor?

MR. YOUNG: Jim, you mentioned $32 billion was the loss due to higher unemployment. Bob Myers suggested to the commission that for every 1% additional unemployment the trust fund loses 2% of its revenues. Is that your basis?

MR. SWENSON: Yes.

MR. SUSHIL K. AHUJA: I have a question for Mr. Swenson. Will the newly covered employees only have to pay into the Social Security system? My understanding of the law is that they will be required to pay into both the Civil Service and the Social Security systems.

MR. SWENSON: That is correct, however I am confident that will be changed prior to January 1, 1984.

MR. TOM J. LEARY: A number of panelists have indicated there is something in the new law to offend everybody, since no one was completely happy. What is likely to happen because people are unhappy? Can we assume that Congress will leave their hands off of Social Security for better or for worse?

MR. YOUNG: My best guess is that with respect to the short run there is not likely to be any tinkering. Everybody was so concerned about the possibility of running out of money and is so relieved that is not going to happen, that I suspect if the Congress could avoid dealing with Social Security issues at all for the next 10 years, it would be delighted to do so. Now I think there will be other pressures. I think people will push for example to extend the concept of the refundable tax credit, but that would be something that would impact the general revenues side of the government rather than the Social Security trust funds.

I think that the Medicare issue which Jim and Bruce properly point to is the real major problem. Something will have to be done about Medicare; otherwise it will run out of money. The issue is whether you can solve that with some financial mechanism or whether you have to deal, as many of us believe, with the structure by which medical care is delivered. Otherwise you can throw all the money in the world at it, and it will soak it up like a black hole.

There is another major problem sitting out there that the Commission recognized but simply pushed to the side because there was no money at all to deal with it. That is the whole issue of the wage earner versus the spouse benefit. Particularly when it is a working woman who is involved. The women's groups are very strong, and rightfully so, in pointing out that we have a structure that was created at a time when we had one wage earner supporting a family. We collect taxes on wages independent of the family unit, but we pay benefits based on a family unit and working women get a very small marginal return on their contribution. Also, women who stay at home are arguing that they should have greater recognition of the economic value of what they contribute. That whole issue will very much be debated and be under discussion, but how soon anyone will come to grips with it is an open question.

MR. JOHN C. WILKIN: There has been a lot of discussion on the assumptions used in the cost estimates that defined the size of the problem. I know that one provision in the law that was not discussed was a partial requirement for the Chief Actuary at Social Security to sign the trustees report. I wonder if there are any comments?

MR. SWENSON: In 1981, when Congress was moving towards enactment of legislation, many of the legislators were looking at the experience that occurred after the 1977 legislation. Then, changes to the system were based upon the best estimate assumptions. However, the economy did not perform up to those best estimate assumptions. In 1981 the members of Congress were looking towards the pessimistic assumptions to base solutions.

MR. YOUNG: I want to go back to the early part of your question. I do not think the issue of the assumptions is a technical debate. Because economic assumptions can always be far apart, I think what became clear -- and has been clear for awhile -- is that one has to be able to deal with the assumptions not working out. It was very clear that there were a handful of possible technical mechanisms -- short of just passing new legislation -- and those were pretty well defined fairly early in the game. There can always be a debate about the assumptions, but the real key of this whole package is that there are some additional mechanisms that come into effect if the assumptions do not work out. If things prove to be more favorable than the assumptions, then in effect money just gets recycled back into the Treasury and gets held there for the future.

MR. SCHOBEL: In the past the Social Security Chief Actuary was not required by law to make any statements as to the reasonableness of the assumptions used in the cost estimates. The annual statements and reports were not reports of the SSA office of the Actuary but were reports of the Board of Trustees. The Board of Trustees could assume anything they wanted and the actuaries cranked out the numbers. It became clear that was not actually happening. The actuaries were recommending assumptions and the Board was adopting them. In 1981, for the first time, the Chief Actuary added a statement to the report on his own certifying that the assumptions were reasonable. No one said to take it out, so it was printed in the report. In 1982 that was done but there was not a requirement in the law for the certification.

When the original Social Security bill, HR 1980, was being considered by House Ways and Means on March 2nd of 1983, a member of Congress introduced an amendment to the bill which said that the Chief Actuary had to certify that the assumptions were reasonable. This passed House Ways and Means and became part of the bill that was considered by the full House on March 9th and also passed. Then the Senate introduced an amendment, that was for all practical purposes the same, which passed in the full Senate. In the Conference Committee on March 24th, in one of the very rare times where public laws are enacted in private, the conferees came out of a back room and announced that the statement by the Chief Actuary would include everything except a certification as to the economic assumptions. He would have to certify as to the reasonableness of all the other assumptions except the economic assumptions. That is how the law now stands. So the Office of the Actuary is in a spot where they have to make a statement as to the reasonableness of all of the assumptions, except for the economic assumptions.

MR. DAVID THOMAS: Social Security has received a bad rap concerning going bankrupt. What is meant is that it is going into a deficit position. Look at the other 75% of the federal budget, or the budget of Connecticut, or Lockheed, Chrysler or any number of other companies. They are bankrupt too on occasion.

In the immediate future there will not be additional tax revenues from taxing benefits because of the $25 thousand and $32 thousand exclusions. As time goes on, the tax revenues would increase because of the lack of indexing. Isn't this analogous to the bracket creep we had in the federal tax structure. You make more money but you cannot buy more. Right now this tax may not be very onerous on retirees making $25 thousand to $32 thousand. But ten years down the road, assuming even a moderate rate of inflation, a $25 thousand retirement income is not going to be worth near what it is now and yet half the benefits will be taxed. Can you address that?

MR. SCHOBEL: First, I should say as an employee of the federal government, I am not really free to say what is fair and what is not fair. But I will give the arguments that other people give why they consider it to be fair or unfair and not attribute those thoughts to myself. The reason that some people feel that the tax on benefits is not fair is that the benefit formula is already weighted in favor of low income people. The rate of return given to high income people is already lower than the rate of return to low income people. The tax on benefits makes that tilt even greater. It lowers further the rate of return for high income people. The problem is if they index those numbers, which they probably will over a 75-year period, then the statement that the long-range deficit has been eliminated is no longer valid. The elimination of that deficit requires the revenue from the taxation of benefits without indexation of the threshold amounts.

MR. THOMAS: I agree that the social adequacy issue is the most important. But I think it is possible that after 10 or 15 years of 5% a year inflation, a $25 thousand pension will put a person in low or middle income.

MR. SCHOBEL: That is exactly why I think those numbers will be indexed. You will have retirees earning $25 thousand in the year 1990 or 1995, and they will write to their Congressmen and say they are not rich and should not be taxed on their benefits.

MR. YOUNG: Whether or not the thresholds will be indexed only determines taxable income. Taxes on that will depend on the basic tax structure itself. Because the basic tax structure does not impose higher marginal rates, even though more may be counted as taxable income, there may not be very much taxes on it.

MR. SWENSON: I had the occasion to speak to a group of senior citizens in a relatively affluent New Jersey community following enactment of the legislation. The audience did not characterize the solutions as balanced because of the taxation aspect. You were looking at fairness in terms of lower income workers paying taxes on their benefits. They were looking at it from the perspective that they were frugal during their working years, worked for employers who had private pension plans and set aside money for their retirement. Now, they are the ones who are paying taxes. They would have considered it fairer had everyone paid taxes.

MR. STEPHEN J. CHURCH: I am concerned about the political will for saving the Social Security program and the problem of IRA's. I think they are intertwined. I have heard the panel say that sometime over the next five to fifteen years we are going to have to deal with saving Social Security again. The people who put up the most and got the least out of the new law are the people under age forty-five. Those people will become a larger part of the political body over time. Is the political will going to save Social Security when these same people will be increasing their retirement savings through IRA's as well as pension plans?

MR. YOUNG: Well, I guess the question as to political will depends to some extent on what you consider as saving Social Security. I think that the recent experience demonstrates that there is a commitment to essentially the kind of Social Security program we have. There was no support for those people who came to the Commission and talked about changing it into an unbundled system, separating the so-called welfare aspects from the savings aspects.

Moving to the new generation being in a private system or anything of that nature in the future, I do not know. Obviously it is too early to tell, but my own guess is that when we tote up the IRA experience, we are going to find that it is a repeat of the private pension experience. Those people who are fairly well off will accumulate IRA programs; those people who are not, will not be in IRA's largely because they do not have the money to put aside, and certainly not to lock up until age 59½. Also, they get a much lower marginal return on their savings than a high income person. I think that the experience under thrift plans is not precisely identical, because under thrift plans you have access to your money when you terminate employment and most people do tend to withdraw their money from thrift plans when they terminate employment. IRA money is clearly locked up for a very long period of time. Someone should investigate the IRA experience by income class. Who is putting money away into IRA's?

I think that the need for Social Security will continue to be evident, and I think that there are also some favorable aspects on the other side. Bruce referred to the fact that the Congress has demonstrated that it will not let much of the compensation base escape FICA taxation, for example, the 401(k) provision. One of the big assumptions that enters into the cost estimates is the degree to which compensation falls under covered earnings or falls outside of covered earnings. There is a very strong assumption -- at least in the 1982 trustee report -- that a growing proportion of compensation is not subject to FICA taxes. If that is neutralized, which it clearly can be by political action, that would change the cost estimates in terms of percent of payroll enormously. You are right; there is the economic base to raise the money. The question of whether the will is there to do it is something we will all see. I am confident that it will be there.

MR. EPLEY: If I may jump in and ask a question which follows Dave's comment about bankruptcy and what Steve said. I have worked with some municipalities and nonprofits, primarily hospitals, analyzing whether they should withdraw from Social Security. One of the things that I have heard so often was this creditability question, "Is the system going bankrupt? I will never get anything from it ... why should I stay in? " I use this example because I think that the bigger question or concern is really a lack of proper communication by the Social Security Administration. Should those of us who are technically knowledgeable about Social Security have some responsibility in communicating to the public in one form or another about Social Security? What can we do or possibly should we be doing to better familiarize the public about Social Security?

MR. SCHOBEL: Personally, I think we are trying to fill some pretty large shoes that are already being filled by the New York Times and the CBS evening news among others. The problem is that a lot of the newspapers and TV networks present a really misleading picture. I think that the American public was scared in the last couple of years. They were told that Social Security was going broke and they were never told that there was virtually a 100% certainty that Congress would not let that happen. I hope that the American public learned something from this episode. We let Social Security get right up to the bankruptcy date, July 1, 1983, but the system was saved. Congress will do what has to be done. When the people see this happen enough times they will understand that the system will be here. How we can convince them of that I do not know.

MR. SWENSON: One of the problems causing lack of public confidence in the program is the communication efforts made by Social Security where they have tried to portray the program as being funded. They were saying that the contributions were set aside until retirement when they were returned. Unfortunately, that is not the way the program has been designed. I frequently get the question, "Will there be money when I retire?", asked by my contemporaries. This is a reflection of this lack of communication. Now I think that the public is becoming better educated. I think actuaries have an important role to play in educating the public. Finally, I think that the political rhetoric in this past year-and-a-half has frightened the heck out of a lot of our senior citizens. The fact is that responsible members of both parties strongly support the new program. Except for a few on the far right, very far right, there is no one saying that the program should be scrapped or privatized, or that even the social adequacy aspect should be eliminated.

MR. YOUNG: Well, the only thing that I would add, but I do not know how to communicate it adequately, is if anybody had a private pension program which was entirely invested in U.S. government bonds and walked around saying that money will not be there 30 years from now to pay those bonds as they come due, they would get laughed out of the room. Yet you have the exactly the same security that the government -- that is, future taxpayers -- will be able to pay on U.S. government bonds as under the Social Security system. The difference is in one case there is "a legally binding commitment of the government," and in the other case you have what the earlier question referred to as the political will to face up to social obligations. There is no difference in real terms if you collect a lot of money, put it into the Social Security trust fund, go out and buy government paper with it, hold those as assets, and say that the system is fully funded. In 1990 or 2000 you face exactly the same problem -- how do you raise the money that year to pay what comes due that year?

MR. EPLEY: Many of us as actuaries have access to the public to be able to support our government and our Social Security system if we want to. There is a large public audience that just does not yet trust the federal government to provide Social Security benefits. I would like to think that we can go away from here having learned more about Social Security and, at the same time, think what can we do to better support the system. Thank you very much.