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## THE 1977 SOCIAL SECURITY AMENDMENTS AND THE YOUNG WORKER—AN ILLUSTRATIVE COMPARISON WITH THE SITUATION UNDER THE 1972 ACT

*by A. M. Niessen*

Less than seven months have elapsed since the enactment of the 1977 social security amendments and already the subject of social security is back in the news. This time, discussion centers around the allegedly harsh treatment that the new law mandates for both young workers and future entrants. Some observers see the situation in such dark colors that they feel justified in calling for a closing down of the System and for the removal of young people from its coverage. The contention is that young people could buy the OASDI benefits for less money from private carriers who presumably would eagerly enter the field. Apparently, these critics take the word "insurance" (the "I" in the "OASDI" program) very seriously. What they fail to see is that the Program is an income redistribution scheme which, although it may be labeled social insurance, is not really insurance in the traditional meaning of the word. Be that as it may, the question of how young workers will be treated under the 1977 Act is here and it is worthwhile to take a closer look at it.

The writer undertook to develop some information based on illustrative examples. With the limited facilities available to him, the writer could make only very rough calculations which, admittedly, do not tell the whole story. Nevertheless, the results of the calculations may be instructive to the reader interested in the subject. The general finding was that the 1977 legislation indeed does do away with the highly favorable treatment implicitly provided to future entrants under the now defunct 1972 Social Security Act. This is clearly evident from the relatively few figures appearing below.

### RELATIONSHIPS BETWEEN BENEFITS AND CONTRIBUTIONS OF NEW ENTRANTS UNDER THE 1972 AND 1977 SOCIAL SECURITY ACTS—AN ILLUSTRATIVE COMPARISON

| | *Maximum wage credits* | | *Two-thirds of maximum* | | *One-half of maximum* | |
|---|---|---|---|---|---|---|
| | 1972 | 1977 | 1972 | 1977 | 1972 | 1977 |
| Initial monthly retirement benefit—PIA | $8,243 | $6,243 | $7,125 | $5,517 | $6,431 | $4,306 |
| Benefits as a percent of final covered earnings (at age 64) | | | | | | |
| Employee alone | 48 | 26 | 63 | 31 | 75 | 36 |
| Employee and wife | 73 | 39 | 94 | 46 | 113 | 54 |
| Present value of 1-percent of future earnings | $5,163 | $7,170 | $3,442 | $4,780 | $2,582 | $3,585 |
| Equivalent level rate of employee's contributions | 5.11% | 5.93% | 5.11% | 5.93% | 5.11% | 5.93% |
| Level cost of benefits as a percent of earnings | | | | | | |
| Employee alone | 6.43 | 3.51 | 8.33 | 4.65 | 10.03 | 4.83 |
| All OASDI benefits | 13.98 | 7.63 | 18.13 | 10.10 | 21.81 | 10.52 |

*TECHNICAL NOTE*: Figures pertain to a man who entered social security coverage in January 1978 at age 22. His retirement is expected in January 2021 at age 65 at which time he will have a wife of the same age eligible for auxiliary benefits at full rates. From 1978 onward, wages will be increasing at the rate of 6% per year and the cost of living at 4½%; interest will be 7½%. Mortality before retirement will be according to the 1969-71 U.S. Life Tables for white persons without adjustment and after retirement mortality will be with a two-year rate back in age. Direct computations for the actuarial values of benefits were made only for those beginning after age 65; the other values were obtained from certain published cost estimates (for the 1972 Act) using ratios to costs of the basic retirement benefits. Administrative costs were disregarded.

Particularly striking is the indication that in none of the cases considered would the value of benefits under the 1977 Act come even close to the value of the employee's and his employer's contributions, whereas under the 1972 law, the value of family benefits (including survivor benefits) would have exceeded the value of the combined contributions. This is not really a defect although the public and the news media tend to view it as such. In addition, it should be noted that the change in level costs for new entrants is a very drastic one which was brought about by a significant increase in contributions as well as by a sizable reduction in potential benefits. All in all, the data here presented would seem to provide good ammunition for the critics of the Social Security System. Obviously, however, there is much more to the new entrants issue and it would be improper to judge the merits of a social security program on the basis of actuarial data developed for only a part of its coverage. The issue of contributions versus actuarially purchasable benefits is a very complex one and perhaps not a really relevant one. Although there may have been in depth discussions of this issue, it would

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## Social Security and Young Worker

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seem that the general public is not familiar with them. This article certainly is not the place for such a discussion but a few general comments might be in order.

The income replacement ratios that are frequently quoted significantly understate the value of Social Security benefits because they relate benefits to gross wages rather than to take home pay. For example, the true ratio for a married man retiring at age 65 in early 1978 (with a dependent wife at least age 65) is 61.4 percent rather than the 50.2 percent obtained from dividing the maximum benefit of $689.70 by $1,375.

As mentioned earlier, Social Security is really an income redistribution scheme, and not an insurance program in the traditional sense. This being so, there should be no criticism if certain groups do not receive the "value" of their contributions. A worthwhile side benefit not usually mentioned by the critics is that Social Security frees the young worker from the obligation of financial aid to his parents or aged relatives, who, in most cases, will be entitled to benefits on their own work records.

It is not altogether clear that private carriers would be willing to venture into the field of truly dynamic benefits. This would, of course, make the whole discussion of farming out the lucrative part of Social Security coverage pointless and strictly of academic interest.

Let us assume for the moment that farming out is feasible and that Social Security would be transformed into a closed system. An educated guess (based on a 1976 estimate of $4.2 trillion under the 1972 law) would place the actuarial deficiency for a closed system under the 1977 law at about $3 trillion. To amortize such an amount over a period of, say, 30 years would take some 8 percent of the personal income derived from employment and investments. Since this would have to come from taxes in one form or another, how then would the younger worker profit from this situation in the foreseeable future?

Public attitudes being what they are, it can be expected that the 1977 reforms will be short lived and that a good part of the cuts in benefit expectations will be eliminated. Another strong possibility is that government subsidies will replace a part of payroll taxes. While this would certainly not reduce the costs of the program, it would make the situation more palatable to the public and this is, after all, what counts in the mind of the politicians. Should general revenue financing become a reality we may well see a revival of expansionist tendencies with all that the implementation of these tendencies would entail for the economy at large, for individuals, and for private pensions. A good public education effort is needed in this area and it is hoped that the actuarial profession will play a prominent part in such an endeavor. □

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## SECOND CALL—PAPERS FOR BANFF

*by Robert E. Hunstad*

The June 7-8, 1979, meeting of the Society of Actuaries to be held at Banff is scheduled as a special topic meeting on Health Insurance.

The Committee on Health and Group Insurance of the Society's Continuing Education Committee has responsibility to assist in the development of the program for this meeting.

Mr. Stephen T. Carter, Chairman of that Committee, has announced that in order to encourage the writing of papers for presentation at this meeting, prizes will be awarded for the two best papers presented.

The first prize will be $300 and the second prize $200. These prizes are being made available by a grant from the Actuarial Education and Research Fund.

The procedure for submitting papers is given in the Year Book. To assure consideration for presentation at the Banff meeting and eligibility for the prize awards, papers should be submitted no later than September 15, 1978. Papers submitted after that date may still be considered for use and for prize awards but have less likelihood of being processed in time.

Any questions may be directed to members of the Health and Group Insurance Committee. They are listed in the Year Book. □

## FUTURE OF RISK—A SYMPOSIUM

*Sponsored by*
*Risk Studies Foundation*

Risk in the immediate and distant future will be scrutinized by scientists, academicians and the business and insurance communities at a symposium to be held by the Risk Studies Foundation from Monday, September 25 to Wednesday, September 27, at the Waldorf-Astoria Hotel in New York. A not-for-profit adjunct of the Risk and Insurance Management Society, the Risk Studies Foundation was founded in 1975 to research the multifaceted fields of risk and insurance management and interrelated disciplines.

Topics to be discussed in the two-and-one-half day forum are: Energy and Economic Dislocations; Future Prospects For Climate Change, Weather Control and Natural Disasters; International Political Flux; Individual Health Patterns; Centralization and The Future Of Crime.

Registration fee for the meeting, . cluding luncheons on September 25 and 26, is $295.00. To register or obtain a descriptive brochure, write Risk Studies Foundation, 205 East 42nd Street, New York, New York 10017. □

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## Trust Funds

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2030. Because of the large number of children born in the 1950's and 1960's, the cost of the system increases rapidly after the first 50 years and remains relatively high. Over the long-range 75-year period, the system is estimated to have a deficit of 1.40 percent of taxable payroll (based on average costs of 13.55 and average taxes of 12.16).

The Boards of Trustees recommend to the Congress not to consider rolling back the social security tax increases enacted last year until the current Social Security Advisory Council finishes its study of the system.

For free copies of any of the three Trustees Reports, write to: Social Security Administration, Office of the Actuary, Altmeyer Building — Room 707, 6401 Security Boulevard, Baltimore, Maryland 21235. □