

Chapter 4

FINANCING SOCIAL SECURITY AND MEDICARE

The chief purpose for which the National Commission was created by the Congress was to find new solutions to the financing problems of Social Security and Medicare.^{1/} Social Security and Hospital Insurance were designed to be self-supporting from payroll tax contributions. Over the years, Congress has acted to provide adequate long-range funding for anticipated benefits. In recent years, the program has been funded on a pay-as-you-go basis, with a relatively small contingency reserve. Taxes paid by current workers are used to make payments to current beneficiaries. Until the last few years, the system has been in close actuarial balance. This means that, over the next 75 years, estimated outgo would be covered by income.

^{1/} The sponsor of the amendment creating the Commission said in a speech on the floor of the House: "The reason that I introduced the amendment was the paucity of information on the various proposals for the long-term financing of our Social Security programs. There is little doubt that H. R. 9346 [the Social Security Amendments of 1977] addresses only the short-term financial needs of these programs. I think it is equally important to assure our taxpayers that we intend to maintain a viable system through long-term solutions." Remarks of Congressman Ed Jenkins, Congressional Record, 95th Congress, 1 st Session, October 27, 1977, pp. 35395-6.

The 1977 Amendments to the Social Security Act established a new schedule of payroll taxes (see Table 4-1). According to the estimates given Congress at the time, these tax rates were sufficient to keep the Social Security program in balance for at least 35 years. These estimates were quickly overtaken by unanticipated negative developments in the economy, especially the combination of unemployment and high inflation with prices rising more rapidly than wages. In the next few years, the combined balances in the Social Security and Hospital Insurance trust funds will run close to the margin of safety. There is sufficient public concern about the possibility of benefits going unpaid, at some point in the future, to make it imperative that the 97th Congress take steps to provide adequate funds during the next few years, as well as enact a sound plan for financing the system in the longer term. The Commission is making a series of recommendations that, taken together, should accomplish these purposes.^{2/ A/}

^{2/} The cost estimates presented in this report for present law, unless otherwise indicated, take into account the four significant amendments enacted in 1980--P.L. 96-265 (Social Security Disability Amendments of 1980), P. L. 96-403 (reallocating the Social Security tax rates for 1980-81 between Old-Age and Survivors Insurance and Disability Insurance), (P. L. 96-473 (making changes in the monthly earnings test and limiting benefits payable to prisoners), and P.L. 96-499 (making certain Social Security and Medicare benefit changes, primarily with regard to home health services).

^{A/} See supplementary and dissenting statements on Social Security financing immediately following this chapter.

How the Programs are Financed

To assess the fiscal prospects of the system, it is first necessary to understand how Social Security and Medicare are financed. There are currently four separate trust funds, each of them a separate account in the United States Treasury.

All financial operations of the Old-Age and Survivors Insurance program (OASI) are handled through the Federal Old-Age and Survivors Insurance Trust Fund, established in 1940. All financial operations of the Disability Insurance program (DI) are handled through the Federal Disability Insurance Trust Fund, established in 1956.

In 1965, a third fund, the Federal Hospital Insurance Trust Fund, was created to handle the portion of Medicare which is financed through payroll taxes and which in this report will be referred to as Hospital Insurance (H I) . Finally, there is the Federal Supplementary Medical Insurance Trust Fund, which was also established in 1965; the premiums paid by individuals and payments from general revenues go into this fund and finance this portion of the Medicare program, which in this report will be referred to as Supplementary Medical Insurance (SMI).

The major source of income for the Old-Age and Survivors Insurance, the Disability Insurance, and the Hospital Insurance Trust Funds is payroll taxes paid by workers and their employers, and by individuals with self-employment income, in work covered by these program&. The payroll taxes are paid at the same rate by both the employer and the employee. Old-Age, Survivors, and Disability

Insurance (OASDI) taxes for the self-employed are approximately 1 1/2 times the employee rate, while those for Hospital Insurance are at the same rate as for employees.^{3/} Table 4-1 shows the tax rates for both Social Security and Hospital Insurance as established by the 1977 Amendments.

Short-Term Financing Recommendations

The financing difficulties of Old-Age, Survivors, and Disability Insurance in the near-term are a result of the unhealthy economic situation that has prevailed over the past five or six years. During most of this century, and until recently, the United States has experienced fairly steady economic growth. In what had come to be accepted as normal, increases in average wages were regularly greater than increases in prices. This resulted in more than enough payroll taxes flowing into the trust funds to pay for benefit increases. The cost estimates made for Congressional consideration of the 1977 Amendments assumed this historical relationship would continue.

^{3/} This figure was chosen as a practical compromise between (a) a rate equal to the combined employee-employer rate which would produce the same total contribution income for a self-employed as for an employed worker and (b) a rate the same as that for the employee, which many persons thought was as much as small farmers, craftsmen, tradesmen, or other independent workers should have to pay. Since the owners of a small business that is incorporated, who pay both the employee and employer contribution on their own salary, can deduct the employer half as a business expense, the 1.5 times the employee rate for the self-employed persons also brings the tax treatment of incorporated and unincorporated businesses closer together than it would otherwise be. The Commission thinks that the tax provisions for self-employed persons now in effect represent a reasonable accommodation to the different interests and considerations involved and recommends no change in this aspect of the program.

They showed that the balances in both the Old-Age and Survivors Insurance and the Disability Insurance Trust Funds would be a minimum of 30 percent of estimated expenditures in 1982 and throughout the rest of this century--and no less than 20 percent before then.

Since these Amendments were enacted, however, the Nation has had a high and prolonged level of inflation which, because Social Security benefits are adjusted to upward changes in the Consumer Price Index, resulted in higher than anticipated benefit outlays. At the same time, wages have risen more slowly than prices, and unemployment has been higher than expected, resulting in outgo exceeding income by more than had been anticipated earlier. The result has been a decline in the size of the trust funds. Under estimates for 1982 made in mid-1980, the balance in the Old-Age and Survivors Insurance Trust Fund would be only 10 percent of expenditures during that year. The balance in the Disability Insurance Trust Fund would be 12 percent, and the balance of the two funds combined would be 10 percent, rather than the 30 percent estimated in 1977.^{4/} The minimum balance in the trust funds at the start of any year must be at least 10 percent of anticipated annual expenditures in order to assure that benefits can be paid on time in each month of the year.

In order to assure adequate funding for 1981, Congress, in October 1980, enacted Public Law 96-403, which provides for a

^{4/} The combined totals come to only 10 percent because the outgo of the OASI fund is about 7.4 times that of the DI fund.

shift of payroll tax receipts in 1980 and 1981 from the Disability Insurance Trust Fund to the Old-Age and Survivors Insurance Trust Fund. The changes in tax rates and the effects on the beginning-of-year balances as a result of this amendment are shown in Tables 4-2 and 4-3. As will be seen from Table 4-3, adequate fund ratios are very likely to be maintained throughout 1981 for both trust funds.

Until very recently, it appeared that this reallocation, plus some borrowing from the Hospital Insurance Trust Fund, might resolve the short-term financing problem. However, the estimates available to the Commission based on the 1980 Mid-Session Review assumptions of the Office of Management and Budget (see Table 4-4) show that the combined assets of all three trust funds will be inadequate to pay estimated benefits as they come due starting in 1984 (see Table 4-5).

The Commission therefore recommends that:

(1) Reallocation of taxes between Old-Age and Survivors Insurance and Disability Insurance, similar to that provided in present law for 1980-81, should be done for later years. Table 4-9 shows the proposed allocations.

(2) Starting in 1981, each of the trust funds should be authorized to borrow from the others whenever needed to assure timely payment of benefits, with the loans being repayable with appropriate interest.

(3) The Hospital Insurance tax rates for 1983-89 should be reduced by 50 percent, and appropriations from general revenues should be made in amounts equal to the Hospital Insurance payroll

tax receipts. In 1990 and after, the Hospital Insurance payroll tax rates should be increased as necessary in order to meet the benefit costs and to build up and maintain a trust fund balance of about one year's outgo (at the same time, of course, the equally matching amounts from general revenues would increase) ^{5/} The resulting necessary tax schedule is shown in Table 4-6 for the combined employer-employee rates and in Table 4-7 for the self-employed rates.

(4) The combined tax rate for Old-Age and Survivors Insurance and Disability Insurance should be increased, beginning in 1983, by amounts adequate to meet the benefit costs and to build up and maintain a trust fund balance of about one year's outgo. However, in 1983-89, such increase should not be larger than the reduction in the Hospital Insurance tax rate, as described in item (2). The resulting necessary tax schedule is shown in Table 4-6 for the combined employer-employee rates and in Table 4-7 for the self-employed rates. Table 4-8 compares the combined employer-employee tax rates under the Commission proposal with those in present law.

The proposed rates for Old-Age, Survivors, and Disability Insurance are higher than under present law for 1983-89, lower for 1990-2019, and higher once again after 2019. The higher rates in the near future are needed both to meet the cash-flow problems

^{5/} After 1990, Hospital Insurance costs are estimated to increase more rapidly than would be covered by the present schedule of tax rates. An increase in the payroll tax for Hospital Insurance will then be required.

and to build up the fund so that it has an adequate ratio. The decrease in the rates in 1990-2019 is possible because by then the fund will have been sufficiently built up and because the ratio of beneficiaries to covered workers will be relatively stable. The subsequent increases are needed as the number of beneficiaries rises in relation to the number of workers, due to the age cohorts of the World War II baby boom then attaining retirement age.

The proposed rates for Hospital Insurance are lower than under present law for 1983-2014, but higher thereafter. The initial decrease is due to the change in the financing procedure, such that one-half of the cost is met from general revenues. The subsequent increases are needed to meet the assumed steady rises in hospital costs and, later, the increase in the ratio of beneficiaries to covered workers.

The proposed rates for both programs combined are the same as under present law for 1983-84, slightly lower for 1985-89, significantly lower for 1990-2019, but higher thereafter. Much of this difference in the next few decades is due to the proposed financing of one-half of the cost of Hospital Insurance from general revenues, while at the same time strengthening the financing of Old-Age, Survivors, and Disability Insurance by increasing its tax rates.

(5) As an emergency measure, the trust funds should be authorized to borrow from the Treasury such amounts as might be needed to assure the timely payment of benefits if revenues prove inadequate. This should be done to make it clear to the public that Congress will not permit any interruption of benefit payments. Loans would be authorized each year in the amount estimated as necessary

to pay benefits, but the actual transfers to the trust funds would be made only as needed to pay the benefits. The borrowing authority should expire at the end of 1985, so as not to create the temptation to let it take the place of needed tax increases. Any loans made should be repaid with interest^{6/} as promptly as funds become available.

The foregoing financing recommendations are based on the entire package of Commission proposals as to benefits and coverage. The effects of these financing proposals on the short-range operations of the three trust funds are shown in Tables 4-10 through 4-14. These also take into account all of the proposals as to benefits and coverage (as described in subsequent chapters), but not as to the borrowing authorities. Table 4-14, for all three trust funds combined, shows that inter-fund borrowing will be sufficient to avoid cash-flow problems, because the fund ratio is well above 10 percent in all years in the next decade.

Table 4-12 shows that the Old-Age, Survivors, and Disability Insurance program will have some cash-flow problems in 1981-85 and thus will need to use the borrowing authority. On the other hand, the Hospital Insurance Trust Fund is in excellent condition

^{6/} Interest should be at the rate which would have been paid on obligations held by the trust funds at the time the loan was made.

and has satisfactory fund ratios, so that it will be able to make loans to the Old-Age and Survivors Insurance Trust Fund. As Table 4-15 shows, such loans can readily be made so as to maintain a satisfactory cash-flow situation for the latter fund. The amounts borrowed from the Hospital Insurance Trust Fund would be about \$4 billion in 1982, \$2 billion in 1983, and \$1 billion in 1984. These loans would be rapidly paid back. In fact, total repayment would be made by the end of 1984, and there would be no necessity to borrow during the period, on an emergency basis, from the Treasury.

The Long-Term Financial Problem

The long-term estimates available to the Commission at the time it considered proposals to change the financing of the program were those in the 1980 Reports of the Board of Trustees.^{7/} Because they are necessarily subject to variation, the estimates are based on 3 different sets of assumptions as to future fertility and mortality rates, inflation, unemployment, and other factors: Optimistic, Intermediate, and Pessimistic (see Tables 4-16 and 4-17). They thus cover a range of possible developments.

^{7/} The Board of Trustees consists of the Secretary of Health and Human Services, the Secretary of Labor, and the Secretary of the Treasury (who is the Managing Trustee).

Old-Age, Survivors, and Disability Insurance Recommendations

The long-range financial status of the Old-Age, Survivors, and Disability Insurance program according to the estimates made in the 1980 Trustees Report is shown in Table 4-18. Under all three sets of assumptions, the Old-Age and Survivors Insurance program is under-financed in the long run, and the Disability Insurance program is over-financed. When the two programs are combined, they are adequately financed only under the optimistic assumptions.

Because of the great uncertainty inherent in long-term projections, it has always been acceptable for the long-range actuarial balance (the relation between anticipated revenues and expenditures over the full 75 year valuation period) to show a small deficit or surplus under the intermediate cost estimates. Under the tax rates of present law, there is an actuarial imbalance under the intermediate estimates in the 1980 Trustees Report of 1.52 percent of taxable payroll. Average expenditures are 112 percent of average income.^{8/}

The Commission considers this an insufficient degree of financing. The tax schedule recommended by the Commission to finance the program which it proposes, supplemented by the payments from general revenues (when expressed as percentages of taxable payroll), would result in a positive actuarial balance of .24 percent of taxable payroll,

^{8/} The costs presented in this report for the Commission's proposals are based only on the intermediate cost estimates. The Commission recognizes the significant range in possible costs as shown by the estimates for the present program in Table 4-18 for the Old-Age, Survivors, and Disability Insurance program (and as discussed subsequently for the Hospital Insurance program). However, for the purposes of this report, it seems adequate to use only the intermediate cost estimates in presenting the proposed changes and in developing the necessary financing provisions therefor.

and average expenditures would be 98 percent of average income. This favorable result as compared with present law is attributable largely to the Commission's proposal to increase the minimum retirement age after the year 2000, to increase the combined OASDI tax rates (in part from the shift of part of the presently scheduled HI tax rate to OASDI) and to the inclusion of government employees under the system. This positive actuarial balance does not represent a real surplus, but rather it is needed to build up and maintain the trust fund balance to a level of about one year's outgo. Table 4-19 shows income and expenditures as a percentage of taxable payroll for the entire 75-year valuation period, both in the aggregate and year by year, for the intermediate cost estimates.

Hospital Insurance Recommendations

As to the Hospital Insurance program, it is also desirable that the balance in the fund should approximate the annual expenditures. The cost estimates in the 1980 Trustees Report as to the actuarial balance of this program have been prepared on this basis. While the estimates are based on three sets of assumptions similar to those used for the Social Security program, the valuation period is only 25 years^{9/}

^{9/} To give the Commission a basis for its analyses, the actuarial staff of the Health Care Financing Administration agreed to project Hospital Insurance costs for 75 years, on the assumption that, after 2005, average hospital costs would increase at the same annual rate as average wages (i.e., 5-3/4 percent). This would, of course, represent a significant slowing down in the rate of health cost increases. By using these figures, the Commission does not necessarily predict this slowdown will occur. Health care costs could well continue to increase as they have in recent years.

The Hospital Insurance Trust Fund will, under present law, be depleted in 1994 under the intermediate assumptions and in 1990 under the pessimistic assumptions. Even under the optimistic set of assumptions, there will only be sufficient funds to pay benefits for 25 years. It should be noted that the intermediate cost estimates for the Hospital Insurance program in the 1980 Trustees Report show that it has a long-range actuarial imbalance over the 25-year valuation period of .99 percent of taxable payroll. The corresponding figure for the pessimistic cost estimate is 2.22 percent, while the optimistic estimate shows an imbalance of .18 percent.

The Commission's recommendation to finance one-half the cost of Hospital Insurance through general revenues, discussed later in this chapter, and to revise the tax rate schedule upward when necessary would keep the Hospital Insurance Trust Fund in a satisfactory position under the intermediate set of assumptions. The tax schedule recommended by the Commission to finance the program which it proposes, supplemented by the payments from general revenues (when expressed as percentages of taxable payroll), would result in a positive actuarial balance of .23 percent of taxable payroll, and average expenditures would be 96 percent of average income. This positive actuarial balance does not represent a real surplus, but rather is needed to build up and maintain the trust-fund balance at a level of about one year's outgo. This is achieved under the estimate on which the financing is based in about 2000.

Fund Accumulation

Recent experience has demonstrated how greatly the balances in the trust funds can fluctuate over short periods. The Commission thinks the trust funds should continue to operate as contingency reserves, adequate to cushion the effect of temporary changes in the economy. For this purpose, they should be built up to a level of about 100 percent of the expected annual outlays. The tax schedule suggested, with the allocations proposed, would accomplish this by 2000 for each of the three trust funds under the intermediate estimates, as shown for the Old-Age, Survivors, and Disability Insurance program by Table 4-19. The Congress will presumably want to look again at the overall financing of the program as conditions develop in the next decade to decide whether this increased level of funding is still needed.

Sources of Financing

The Commission looked at a number of possible sources for the future financing of Social Security including general revenues, a value added tax, and earmarked taxes from specific sources (such as an excise tax on gasoline and revenues from oil or gas recovered from Federal lands). The primary source of funds to pay Social Security benefits has been, and the Commission believes should remain, the payroll tax. The link between payroll taxes and benefits is important both to the acceptance and the strength of the system. The American people want an opportunity to contribute

to their own security. The Commission's special studies and hearings confirmed that the link between the payroll tax and benefits makes the tax acceptable.^{10/}

The payroll tax taken alone is a regressive tax, bearing more heavily on the poor than on the rich. It is levied on the first dollar of earnings, up to a maximum, and not on very high earnings, and not on interest, dividends, or other unearned income. Under Social Security, however, that regressivity is compensated for by the weighting in the benefit formula which makes the combined tax-benefit system progressive. The immediate burden of the payroll tax on very low income workers has been mitigated since 1975 by the earned-income tax credit for workers with children. If it were not for the maximum limit on the amount of earnings that are taxable (\$29,700 in 1981), the payroll tax would be a proportional one (i .e., levied at the same rate regardless of earnings).

General Revenues

While the Commission regards the payroll tax as the most appropriate primary revenue source for Social Security, it would like to end exclusive reliance on it. The Commission believes that there is a point past which payroll taxes for Social Security and Hospital Insurance cannot be used without burdening workers unfairly. Some assurance should be given to workers that their direct contributions to Social Security and Hospital Insurance combined will not go above a specified rate.

^{10/} A Nationwide Survey of Attitudes Toward Social Security a report prepared for the National Commission on Social Security by Peter D. Hart Research Associates, Inc., 1979, pp. 32-33.

For this reason, the Commission recommends a cap on the payroll tax rates for OASDI-HI of 18 percent--g percent on employees and 9 percent on employers-- with an appropriate corresponding cap for the self-employed. Should the cost of the program rise, otherwise necessitating a tax of more than 9 percent each on employers and employees, the Commission recommends that the additional funds be provided from general revenues. A/ B/ This cap would, under the intermediate cost estimates used in this report, first go into effect in 2025 (see Table 4-6).

A need for additional financing would arise sooner if Hospital Insurance costs continue to escalate much more rapidly than average wages and/or if economic and social conditions are not as favorable as those assumed for the intermediate cost estimates.

The use of general revenues to augment the proceeds of the payroll tax is supported on several grounds. Because the personal income tax (that provides the bulk of general revenues) is a progressive tax, levied on other income as well as on earnings, general revenue monies reflect an element of social responsibility and shared community interests. C/ Were it not for the Social Security program, the amounts

A/ Mr. Laxson, Mr. MacNaughton, Mr. Myers, and Mr. Rodgers & sent from this recommendation. Their views appear immediately after this chapter.

B/ By Mr. Cohen, Ms. Duskin, and Ms. Miller: While we support the principle of general revenue financing, we would have preferred to set a lower level of payroll taxes as the trigger point for the introduction of across-the-board general revenues. We endorse the principle of a tripartite financing plan in which one-third of the cost is paid for by payroll taxes from employees, one-third from employers, and one-third from general revenues.

C/ By Mr. Myers: I believe that general revenues derived from income taxes may not, in actuality, be progressive in nature, because higher income taxes may only serve to change the incomes structure of the Nation.

that would have to be spent on public assistance--financed from general revenues--would be very much greater than they are today.

A number of the specific features of the Social Security program involve social costs that should appropriately be paid for, at least in part, by society as a whole. Among the more important are the weighting in the benefit formula in favor of low-earners, the indexing of earnings credits and benefits to maintain their real value under changing economic circumstances, and the payment of full benefits to workers near retirement age when the program started or when coverage was extended, even though their own payroll taxes and those of their employers covered only a very small fraction of the costs. The excess costs for persons who were not covered, and for whom contributions were not paid throughout their entire working lifetime, amount in the aggregate to approximately one-third of the total long-range cost of the program.

Financing Hospital Insurance

The Medicare program provides service benefits that do not vary with earnings and which vary greatly from one person to another. The use of general revenues to finance at least part of the cost of health service benefits is appropriate. General revenues in the beginning covered half of the costs of Supplementary Medical Insurance and currently cover about 70 percent, the remainder coming from the premiums paid by individuals. The Commission recommends extending the use of general revenues to cover one-half of the cost of the Hospital Insurance part of the program. The remaining one-half,

financed through the payroll tax, would continue to be financed by taxes levied equally on employers and employees (and by the self-employed paying the employee rate). ^{D/}

In order to maintain public awareness of the total costs of the program and to provide a sense of fiscal responsibility, the Commission recommends the introduction of a 2.5 percent surcharge on individual income taxes, to be identified as a tax for Hospital Insurance, but with the proceeds paid into the general fund of the Treasury. The objective would be to yield approximately one-half of the revenue needed to finance the general revenue contribution to the Hospital Insurance Trust Fund. The surcharge could result in an actual increase in income taxes, or could be offset by planned tax reductions.

Value Added Tax and Other Tax Sources

A value added tax has been suggested as an alternative to increasing payroll taxes to finance the Social Security and Hospital Insurance programs. The National Commission, however, does not recommend using such a tax.

Studies of the economic effects of a value added tax indicate that it would have different economic effects than a tax on personal income or a payroll tax. An analysis prepared for the Commission by Chase Econometrics as to various changes which might be made in the way Social Security is financed found that the substitution of a 5 percent value added tax for a part of the payroll tax would have significant adverse effects on the economy. It would reduce the Gross National

^{D/} By Mr. Cohen, Mr. Dillman, Ms. Duskin, and Ms. Miller: We concur in the desirability of immediate action to provide one-half of the costs of Hospital Insurance from general revenues. After the Congress has taken affirmative action on this matter, we believe it would then be desirable to reexamine the appropriate level of payroll taxes in relation to the future condition of the economy, productivity, the future cost of the program, and the level of general taxes and the Budget.

Product, increase prices and unemployment rates, and reduce demand for consumer goods.^{11/}

From time to time, it has been suggested that partial funding for Social Security could come from earmarked revenues from Federal excise taxes, such as those on gasoline, or revenues from Federal lands leased for the mining or recovery of minerals, such as off-shore oil lands. While these proposals have the potential of taking a considerable tax burden off both employers and workers, their yearly yield is not sufficiently predictable. The Social Security and Hospital Insurance trust funds need to have a steady, uninterrupted funding source to assure timely payment of benefits and confidence in the system.

Maximum Taxable Earnings Base

Over the years, the maximum earnings taxed for Social Security purposes has encompassed the total earnings of varying percentages of the work force covered by the program. The original \$3,000 maximum covered the earnings of 97 percent of all covered workers. Over the years, the maximum was increased, but more slowly than the rate at which earnings increased.^{12/}

^{11/} However, when the same analysis examined alternative methods of financing the Hospital Insurance program, the use of a significantly smaller value added tax in place of the payroll tax seemed to have effects similar to those of other proposals for substituting general revenues for payroll taxes.

Chase Econometric Associates, Inc., Analysis of Principal Financing Options for Social Security, prepared for the National Commission on Social Security, March 1980, p. 11.

^{12/} The 1972 Amendments, which authorized the automatic cost-of-living increases in benefits, also authorized automatic increases in the earnings base, to be determined from the rises in average wages.

Under the 1977 Amendments, a more rapid relative rise in the maximum earnings taxed for Social Security purposes was authorized. Rather than limit the rise in the amount of earnings taxed to the automatic increases which occur as earnings levels rise, the 1977 Amendments provided specific maximums--\$22,900 for 1979, \$25,900 for 1980, and \$29,700 for 1981. (If it had not been for these increases, the base for 1981 under the automatic-adjustment provisions would have been only \$22,200). Starting in 1982, the maximum taxable earnings base will rise again automatically according to increases in average wages.

The National Commission believes that these legislated increases were too large. People at the higher earnings levels receive benefits which represent a lower replacement of pre-retirement earnings. This is because they are expected to provide, in large part, for their own retirement through a combination of personal savings and private pension plans, which are generally integrated with Social Security. The current taxable maximum is too high, cutting into the proper role that private savings and pensions play in the total scheme of income maintenance.

To reduce the tax base to a figure closer to the level which existed before the 1977 Amendments, the Commission recommends that the maximum earnings taxed for 1985 and 1986 should be frozen at the 1984 level, and that starting in 1987, the base should rise under the present automatic provisions. As a result, the base would be

held at the 1984 amount (estimated according to the 1980 OMB Mid-Session Review assumptions to be \$39,000) for 1985 and 1986, rather than increase to an estimated \$42,300 for 1985 and \$45,600 for 1986' (see Table 4-21).

Adoption of this proposal, when considered after the other financing recommendations of the Commission (as well as the proposed extensions of coverage), would reduce the income to the Social Security and Hospital Insurance programs by \$3.8 billion in 1985 and by \$9.5 billion in 1986. However, these reductions in payroll tax income were taken into account in setting the tax rates shown in Tables 4-6, 4-7, and 4-8.^{E/}

Summary of Financing Proposal and Commission's Tax Schedule

The Commission is making a number of recommendations that would have an effect on the costs of the Social Security and Hospital Insurance programs. Table 4-22 shows the additional costs under the Old-Age, Survivors, and Disability Insurance program in the short range according to the various proposed changes (similar data for the Hospital Insurance program are given in Chapter 13).

The significant aspects of the Commission's financing proposal are the strengthened financing of the cash benefits program in the near future, the lessening of the increase in the payroll tax due to rising Hospital Insurance costs because of the use of general revenues,

^{E/} By Mr. Cohen, Ms. Duskin, and Ms. Miller: We take exception to the freezing of the maximum earnings base in 1985-86 for contributions and benefits, because it results in a loss of approximately .4 percent of payroll for Social Security and Hospital Insurance over the long-run. We think it is not financially prudent to forego this income to the system in light of the majority's concern over the financial future of the program.

and, in the next century, the lower costs for these benefits that would result from raising the minimum retirement age and other proposals of the Commission.

The average long-range costs of the individual Social Security proposals are shown in Table 4-23, while Table 13-3 in Chapter 13 gives corresponding information for the Hospital Insurance program. The net effect of all those relating to the cash benefits, when account is taken of their interactions, would be a reduction of 1.08 percent of taxable payroll below the estimated average expenditures of 13.80 percent under present law in the period 1980-2054.^{13/} Together with increases in the scheduled tax rates, this would result in a positive long-range actuarial balance for the Old-Age, Survivors, and Disability Insurance program of .24 percent of taxable payroll (see Table 4-23), which should assure sufficient financing for the program over the long-run.

Because of the reduction of the payroll tax for Hospital Insurance under the Commission's proposals, the combined payroll tax rate for Old-Age, Survivors, and Disability Insurance and Hospital Insurance would be the same as or slightly lower than that now scheduled until the year 2020. Thereafter, the estimated increases in the cost of the Hospital Insurance program result in the higher combined rates shown in Table 4-8.

^{13/} The cost of the expenditures for present law shown in Table 4-23 (13.80 percent of taxable payroll) differs from that shown in Table 4-18 from the 1980 Trustees Report (13.74 percent of taxable payroll) because of the counteracting effects of considering in the former the short-range economic assumptions in the OMB Mid-Session Review and the several amendments enacted in late 1980.

The present tax schedule for the Hospital Insurance program is based on a 25-year valuation period and, as stated earlier, is estimated to be insufficient to cover expenditures much beyond 1990. All estimates of future hospital costs, especially those beyond the year 2000, are speculative. The tax rates for Hospital Insurance and the general fund expenditures shown in Table 4-6 imply a total cost for Hospital Insurance after about 2030 of approximately 8 percent of taxable payroll. The HI tax rate of 2.9 percent (employee and employer combined) now scheduled would obviously have to be increased or supplemented by general revenues if these cost estimates prove to be anywhere near correct. However, under the Hospital Insurance tax schedule under the National Commission proposal (and with the proposed financing from general revenues), the program is in somewhat more than actuarial balance over the 75-year valuation period.

The Supplementary Medical Insurance program is financed on a year-by-year basis by making any necessary increases in the amount of the enrollee premiums and in the corresponding per capita amounts paid from general revenues. The trust fund balances are currently somewhat more than adequate to meet the accrued liabilities. As of June 30, 1980, the trust fund balance of \$4.7 billion was estimated to be about 38 percent more than the benefits incurred but not yet paid (and accompanying administrative expenses).

Improving the Cost-Estimating Process

The work of the actuaries of the Social Security Administration and the Health Care Financing Administration is held in high regard

in the actuarial profession. The methods used in estimating the cost of the program were evaluated recently by a distinguished independent consultant group appointed by the 1979 Advisory Council on Social Security. This group thought that the methodology and assumptions underlying the cost estimates were reasonable and prudent, and it also made several suggestions for changes, which the actuaries have adopted.^{14/} This Commission has several other recommendations to improve the estimating process.

In setting the schedule of taxes in the law, Congress should be guided by cost estimates covering a range of reasonable possibilities. The current estimates, as discussed, are based on 3 sets of assumptions ranging from optimistic to pessimistic, with an intermediate estimate being the basis for the tax schedule in the law. While the intermediate estimate may result in a reasonable average for the 75-year valuation period, it does not provide an accurate analysis of the year-by-year cash-flow needs. Recently, the intermediate estimates have been more optimistic than actual experience.

^{14/} Report of the 1979 Advisory Council on Social Security Reprinted by the Committee on Ways and Means, WMCP: 96-45, 96th Congress, 1st Session, January 2, 1980, Appendix B.

The Commission, therefore, suggests that the actuaries experiment with new ways of displaying a range of possibilities so as to give the policymaker a better idea of how expenditures and income might be affected as economic and social conditions change. One useful experiment would be to attempt to reflect cyclical economic change in the estimates. This would allow policymakers to judge the adequacy of the financing at different points in an economic cycle, rather than to have to make judgments based on income and expenditures averaged over the entire cycle or (in the case of the long-range estimates) over several cycles .^{15/}

The estimates are based on a subjective evaluation of future economic and demographic trends. There is a considerable range and combination of these assumptions that might be considered reasonable. Moreover, specific assumptions or combinations of assumptions could be put forward for budgetary or other reasons having little relationship to the needs of the Social Security program. Under the present procedures, responsibility for developing the

^{15/} The Commission notes, with approval, the start of such a procedure in "Social Security and Economic Cycles, " Subcommittee on Social Security, Committee on Ways and Means, U .S. House of Representatives. Committee Print WMCP: 96-75 (96th Cong., 2nd Session), U.S. Government Printing Office, 1980.

assumptions and preparing the estimates is divided within the Department of Health and Human Services. Moreover, the estimates themselves are prepared in two separate offices, one in the Social Security Administration and the other in the Health Care Financing Administration .^{16/}

The Commission believes that this procedure would be improved if the assumptions and the estimates were prepared under the supervision of a single Chief Actuary who would be required in the Trustees Reports to certify that the techniques used in preparing the estimates are generally accepted in the actuarial profession and to state the governmental sources of the assumptions used in making the estimates (and whether he or she is in agreement with them).

^{16/} In the Social Security Administration, the current procedure generally starts with the Chief Actuary developing a set of long-range ultimate assumptions. Then, the Chief Actuary, in conjunction with economists in the Office of Research and Statistics in the Social Security Administration, develops a set of short-range assumptions which are constrained by Office of Management and Budget assumptions in the first few years. All of these assumptions are later conveyed to the Commissioner of Social Security and to the staff of the Secretary of Health and Human Services, as well as to the staffs of the Secretaries of Treasury and of Labor. These staffs analyze the assumptions, discuss them with the actuaries and economists, and make whatever suggestions they believe are necessary. The assumptions agreed upon by the staffs become final when adopted by the Board of Trustees. A similar procedure is followed in the Health Care Financing Administration.

Table 4-1

**TAX RATES FOR SOCIAL SECURITY AND HOSPITAL INSURANCE
PROGRAMS UNDER 1977 AMENDMENTS**

<u>Period</u>	<u>OASI</u>	<u>DI</u>	<u>OASDI</u>	<u>HI</u>	<u>Total</u>
		<u>Employer and Employee, Each</u>			
1979-80	4.330%	.750%	5.08%	1.05%	6.13%
1981	4.525	.825	5.35	1.30	6.65
1982-84	4.575	.825	5.40	1.30	6.70
1985	4.750	.950	5.70	1.35	7.05
1986-89	4.750	.950	5.70	1.45	7.15
1990 and after	5.100	1.100	6.20	1.45	7.15
		<u>Self-Employed</u>			
1979-80	6.0100%	1.0400%	7.05%	1.05%	8.10%
1981	6.7625	1.2375	8.00	1.30	9.30
1982-84	6.8125	1.2375	8.05	1.30	9.35
1985	7.1250	1.4250	8.55	1.35	9.90
1986-89	7.1250	1.4250	8.55	1.45	10.00
1990 and after	7.6500	1.6500	9.30	1.45	10.75

Table 4-2

SOCIAL SECURITY (CASH BENEFITS) TAX RATES .
(Employer and Employee, Each)

<u>Year</u>	<u>Law Prior to Public Law 96-403</u>			<u>After Public Law 96-403</u>		
	<u>OASI</u>	<u>DI</u>	<u>Total</u>	<u>OASI</u>	<u>DI</u>	<u>Total</u>
1980	4.330%	.750%	5.08%	4.52%	.56%	5.08%
1981	4.525	.825	5.35	4.70	.65	5.35

Table 4-3

ESTIMATED SOCIAL SECURITY FUND RATIOS, ^{a/}
1981-82

<u>Year</u>	<u>Law Prior to Public Law 96-403</u>			<u>After Public Law 96-403</u>		
	<u>OASI</u>	<u>DI</u>	<u>Combined Funds</u>	<u>OASI</u>	<u>DI</u>	<u>Combined Funds</u>
1981	14%	43%	18%	17%	20%	18%
1982	4	58	10	10	12	10

^{a/} Fund at beginning of year as percentage of outgo in year.

Note: These estimates are based on OMB Mid-Session Review assumptions as to economic developments.

Table 4-4

SELECTED ECONOMIC ASSUMPTIONS UNDER 1980 MID-SESSION
ASSUMPTIONS OF OFFICE OF MANAGEMENT AND BUDGET, BLENDED INTO LONG-RANGE
ASSUMPTIONS IN 1980 TRUSTEES REPORT (INTERMEDIATE) BEGINNING IN
1985-86, CALENDAR YEARS 1980-90

Calendar Year	Average Annual Percentage Increase		Real Wage Differential ^{b/} (percent)	Average Annual Unemployment Rate (percent)	Average Annual Interest Rate (percent)
	Real GNP ^{a/}	Consumer Price Index			
1980	-1.4	13.4	-4.8	7.6	10.0
1981	.3	9.7	-	8.5	9.6
1982	3.8	8.9	.9	8.0	9.4
1983	4.2	7.8	.8	7.3	8.7
1984	4.3	6.9	1.1	6.6	7.8
1985	4.3	6.2	1.3	6.0	7.2
1986	3.7	6.0	1.4	5.7	7.4
1987	3.4	6.0	1.7	5.5	7.6
1988	3.3	6.0	1.7	5.3	7.8
1989	3.3	6.0	1.8	5.1	7.9
1990	2.9	6.0	1.8	5.0	8.0

a/ The total output of goods and services expressed in constant dollars.

b/ The difference between the percentage increase in average annual wages in covered employment and the percentage increase in the average annual CPI.

Table 4-5

**ESTIMATED FUND RATIOS^{a/} FOR SOCIAL SECURITY AND
HOSPITAL INSURANCE PROGRAMS, PRESENT LAW, 1980-90**

<u>Year</u>	<u>OASI</u>	DI	<u>OASDI</u>	HI	<u>OASDI and HI</u>
1980	23%	35%	24%	54%	29%
1981	17	20	18	52	23
1982	10	12	10	64	19
1983	1	30	4	73	16
1984	-10	52	-3	79	12
1985	-20	79	-9	83	8
1986	-26	127	-9	87	9
1987	-31	180	-8	93	12
1988	-36	235	-6	94	15
1989	-39	291	-3	90	17
1990	-42	347	0	82	19

^{a/} Fund at beginning of year as percentage of outgo in year.

Note: These estimates are based on assumptions as to economic developments as shown in Table 4-4. They are presented in Social Security and Economic Cycles, Subcommittee on Social Security, Committee on Ways and Means, House of Representatives, WMCP:96-75, 96th Congress, 2nd Session, November 12, 1980 (Table 5).

Table 4-6

COMBINED EMPLOYER-EMPLOYEE TAX RATES AND PAYMENTS FROM
 GENERAL REVENUES (EXPRESSED AS PERCENTAGES OF **TAXABLE**
 PAYROLL) FOR SOCIAL SECURITY AND HOSPITAL PROGRAMS UNDER
 NATIONAL COMMISSION PROPOSALS

Period	OASDI			HI			Total		
	Payroll Tax	General Revenues	Total	Payroll Tax	General Revenues	Total	Payroll Tax	General Revenues	Total
1981	10.7 %	-	10.7%	2.60%	-	2.6%	13.30%	-	13.3%
1982	10.8		10.8	2.60		2.6	13.40	-	13.4
1983-84	12.1		12.1	1.30	1.30%	2.6	13.40	1.30%	14.7
1985	12.6		12.6	1.35	1.35	2.7	13.95	1.35	15.3
1986-89	12.6		12.6	1.45	1.45	2.9	14.05	1.45	15.5
1990-94	11.2		11.2	1.85	1.85	3.7	13.05	1.85	14.9
1995-99	11.2		11.2	2.30	2.30	4.6	13.50	2.30	15.8
2000-04	10.0		10.0	2.60	2.60	5.2	12.60	2.60	15.2
2005-09	10.0		10.0	2.85	2.85	5.7	12.85	2.85	15.7
2010-14	10.5		10.5	2.85	2.85	5.7	13.35	2.85	16.2
2015-19	11.9		11.9	3.00	3.30	6.0	14.90	3.00	17.9
2020-24	13.4		13.4	3.30	3.00	6.6	16.70	3.30	20.0
2025-29	14.35	.45%	14.8	3.65	3.65	7.3	18.00	4.10	22.1
2030-34	14.00	1.40	15.4	4.00	4.00	8.0	18.00	5.40	23.4
2035-39	13.85	1.65	15.5	4.15	4.15	8.3	18.00	5.80	23.8
2040 and after	13.85	1.75	15.6	4.15	4.15	8.3	18.00	5.90	23.9

Table 4-7

SELF-EMPLOYED TAX RATES AND PAYMENTS FROM GENERAL REVENUES
 EXPRESSED AS PERCENTAGES OF TAXABLE PAYROLL) FOR SOCIAL
 SECURITY AND HOSPITAL INSURANCE PROGRAMS UNDER NATIONAL
 COMMISSION PROPOSALS

Period	OASDI			HI			Total		
	Payroll Tax	General Revenues	Total	Payroll Tax	General Revenues	Total	Payroll Tax	General Revenues	Total
1981	8.00%	-	8.00%	1.30%	-	1.30%	9.30%	-	9.30%
1982	8.05	-	8.05	1.30	-	1.30	9.35	-	9.35
1983-84	9.05	-	9.05	.65	.65%	1.30	9.70	.65%	10.35
1985	9.45	=	9.45	.675	.675	1.35	10.125	.675	10.80
1986-89	9.45	-	9.45	.725	.725	1.45	10.175	.725	10.90
1990-94	8.40	-	8.40	.925	.925	1.85	9.325	.925	10.25
1995-99	8.40	-	8.40	1.15	1.15	2.30	9.55	1.15	10.70
2000-04	7.50	-	7.50	1.30	1.30	2.60	8.80	1.30	10.10
2005-09	7.50	-	7.50	1.425	1.425	2.85	8.925	1.425	10.35
2010-14	7.85	-	7.85	1.425	1.425	2.85	9.275	1.425	10.70
2015-19	8.90	-	8.90	1.50	1.50	3.00	10.40	1.50	10.90
2020-24	10.05	-	10.05	1.65	1.65	3.30	11.70	1.65	13.35
2025-29	10.75	.35%	11.10	1.825	1.825	3.65	12.575	1.825	14.75
2030-34	10.50	1.05	11.55	2.00	2.00	4.00	12.50	3.05	15.55
2035-39	10.40	1.20	11.60	2.075	2.075	4.15	12.475	3.275	15.75
2040 and after	10.40	1.30	11.70	2.075	2.075	4.15	12.475	3.375	15.85

Table 4-8

COMPARISON OF COMBINED EMPLOYER-EMPLOYEE TAX RATES
UNDER NATIONAL COMMISSION PROPOSALS WITH THOSE UNDER
PRESENT LAW

Period	OASDI		HI		Total	
	Present Law	Proposed Plan	Present Law	Proposed Plan	Present Law	Proposed Plan
1983-84	10.8%	12.1 %	2.6%	1.30%	13.4%	13.40%
1985	11.4	12.6	2.7	1.35	14.1	13.95
1986-89	11.4	12.6	2.9	1.45	14.3	14.05
1990-94	12.4	11.2	2.9	1.85	15.3	13.05
1995-99	12.4	11.2	2.9	2.30	15.3	13.50
2000-04	12.4	10.0	2.9	2.60	15.3	12.60
2005-09	12.4	10.0	2.9	2.85	15.3	12.85
2010-14	12.4	10.5	2.9	2.85	15.3	13.35
2015-19	12.4	11.9	2.9	3.00	15.3	14.90
2020-24	12.4	13.4	2.9	3.30	15.3	16.70
2025-29	12.4	14.35	2.9	3.65	15.3	18.00
2030-34	12.4	14.0	2.9	4.00	15.3	18.00
2035-39	12.4	13.85	2.9	4.15	15.3	18.00
2040 and after	12.4	13.85	2.9	4.15	15.3	18.00

Note: The amount of the payments from general revenues are not included (for 1983 and after for Hospital Insurance and for 2025 and after for Old-Age, Survivors, and Disability Insurance).

TABLE 4-9

**ALLOCATION OF COMBINED EMPLOYER-EMPLOYEE TAX
RATES FOR SOCIAL SECURITY PROGRAM AS BETWEEN
OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY
INSURANCE TRUST FUNDS UNDER NATIONAL COMMISSION
PROPOSALS**

<u>Period</u>	<u>OASI</u>	<u>DI</u>	<u>OASDI</u>
1981	9.40%	1.30%	10.70%
1982	9.50	1.30	10.80
1983-84	10.71	1.39	12.10
1985-89	11.20	1.40	12.60

NOTE: For years after 1990, the allocation would be made in a similar manner, in a fashion so that the fund ratios of the two trust funds, year by year, would be about the same. The allocation of the total tax rate for the self-employed would be computed by applying to the self-employed tax rate the same proportions as occur for the combined employer-employee rate, above.

Table 4-10

ESTIMATED OPERATIONS OF OLD-AGE AND SURVIVORS INSURANCE
TRUST FUND UNDER NATIONAL COMMISSION PROPOSALS, 1980-90
(amounts in billions)

<u>Calendar Year</u>	<u>Income</u>	<u>Outgo</u>	<u>Net Income</u>	<u>Fund at End of Year</u>	<u>Fund Ratio^{a/}</u>
1980	\$105.7	\$108.4	-\$2.7	\$22.0	23%
1981	119.2	126.5	- 7.3	14.6	17
1982	139.5	144.0	- 4.5	10.1	10
1983	165.2	162.4	2.8	13.0	6
1984	190.0	179.7	10.3	23.3	7
1985	217.4	196.8	20.6	43.9	12
1986	237.7	214.0	23.7	67.6	21
1987	261.4	231.8	29.6	97.2	29
1988	287.7	250.5	37.3	134.5	39
1989	317.3	270.1	47.2	181.7	50
1990	314.5	291.0	23.5	205.2	62

^{a/} Assets at beginning of year as percentage of outgo during year.

Table 4-11

'ESTIMATED OPERATIONS OF DISABILITY INSURANCE TRUST FUND
 UNDER NATIONAL COMMISSION PROPOSALS, 1980-90
 (amounts in billions)

<u>Calendar Year</u>	<u>Income</u>	<u>outgo</u>	<u>Net Income</u>	<u>Fund at End of Year</u>	<u>Fund Ratio^{a/}</u>
1980	\$13.8	\$15.9	-\$2.1	\$3.6	35%
1981	16.5	17.7	-1.2	2.4	20
1982	18.7	19.8	-1.1	1.3	12
1983	22.1	21.7	.4	1.7	6
1984	24.8	23.5	1.3	3.0	7
1985	27.3	25.3	2.0	5.0	12
1986	29.8	27.3	2.5	7.5	18
1987	32.8	29.2	3.5	11.0	26
1988	36.0	31.6	4.5	15.5	35
1989	39.7	34.1	5.7	21.1	45
1990	37.9	36.9	1.0	22.1	57

^{a/} Assets at beginning of year as percentage of outgo during year.

Table 4-12

ESTIMATED OPERATIONS OF COMBINED OLD-AGE AND SURVIVORS
INSURANCE AND DISABILITY INSURANCE TRUST FUNDS UNDER
NATIONAL COMMISSION PROPOSALS, 1980-90
(amounts in billions)

<u>Calendar Year</u>	<u>Income</u>	<u>outgo</u>	<u>Net Income</u>	<u>Fund at End of Year</u>	<u>Fund Ratio^{a/}</u>
1980	\$119.5	\$124.3	-\$4.7	\$25.5	24%
1981	135.7	144.2	-8.5	17.0	18
1982	158.3	163.8	-5.5	11.5	10
1983	187.2	184.0	3.2	14.7	6
1984	214.8	203.2	11.6	26.3	7
1985	244.7	222.2	22.6	48.9	12
1986	267.5	241.3	26.2	75.1	20
1987	294.2	261.0	33.1	108.2	29
1988	323.8	282.0	41.7	150.0	38
1989	357.0	304.2	52.9	202.8	49
1990	352.4	327.9	24.5	227.3	62

^{a/} Assets at beginning of year as percentage of outgo during year.

Table 4-13

ESTIMATED OPERATIONS OF HOSPITAL INSURANCE
TRUST FUND under National Commission Proposals, 1980-89
(amounts in billions)

<u>Calendar Year</u>	<u>Income</u>	<u>outgo</u>	<u>Net Income</u>	<u>Fund at End of Year</u>	<u>Fund Ratio^{a/}</u>
1980	\$26.0	\$24.6	\$1.5	\$14.7	54%
1981	34.4	28.2	6.2	20.9	52
1982	42.5	33.6	8.9	29.8	62
1983	48.0	38.6	9.4	29.2	77
1984	53.8	44.3	9.5	48.7	89
1985	60.7	50.9	9.9	58.6	96
1986	70.1	58.5	11.6	70.1	100
1987	76.7	67.1	9.6	79.8	104
1988	83.5	77.0	6.5	86.2	104
1989	90.7	88.0	2.7	89.0	98
1990	121.6	100.5	21.2	110.1	89

^{a/} Assets at beginning of year as percentage of outgo during year.

TABLE 4-14

ESTIMATED OPERATIONS OF ALL THREE TRUST FUNDS
 COMBINED UNDER NATIONAL COMMISSION PROPOSALS, 1980-90
 (amounts in billions)

<u>Calendar Year</u>	<u>Income</u>	<u>outgo</u>	<u>Net Income</u>	<u>Fund at End of Year</u>	<u>Fund Ratio^{a/}</u>
1980	\$145.6	\$148.9	\$-3.3	\$40.2	29%
1981	170.1	172.4	-2.3	37.9	23
1982	196.9	197.4	-.4	37.5	19
1983	239.1	222.6	16.4	53.9	17
1984	268.6	247.5	21.1	75.0	22
1985	305.5	273.1	32.4	107.4	27
1986	337.6	299.8	37.8	145.2	36
1987	370.9	328.1	42.8	188.0	44
1988	407.3	359.1	48.2	236.2	52
1989	447.7	392.1	55.6	291.8	60
1990	474.0	428.4	45.7	337.5	68

a/ Assets at beginning of year as percentage of outgo during year.

Table 4-15

INTERFUND LOAN OPERATIONS UNDER NATIONAL
COMMISSION PROPOSALS, 1982-85
(in billions)

Calendar Year	Amount Borrowed by OASDI from HI	Amount of terest Paid by OASDI to HI	Amount of Loan Principal Repaid to HI	Total Outstanding Amount of Loans to OASDI at End of Year
1982	\$3.8	*		\$3.8
1983	2.3	.3	\$6.2	
1984	.7	*	.7	
1985				
Total 1982-85	6.9	.4	6.9	NA

* Less than \$50 million.

NOTE: The estimates are based on the OMB 1980 Mid-Session Review economic assumptions.

Table 4-16
Selected Economic Assumptions Under Alternative I, II & III
1980 Trustees Reports, Calendar Years 1960-2055

Calendar Year	Average Annual Percentage Increase					Average Annual Interest Rate ^{c/} (percent)	Average Annual Unemployment Rate (percent)
	Real GNP ^{a/}	Wages in Covered Employment	Consumer Price Index	Real Wage Differential ^{b/} (percent)			
1960-64-----	4.0	3.4	1.3	2.1	3.7	5.7	
1965-69-----	4.3	5.4	3.4	1.9	5.2	3.8	
1970-74-----	2.5	6.3	6.1	.2	6.7	5.4	
1975-----s-s-	-1.3	6.6	9.1	-2.5	7.4	8.5	
1976-----	5.9	8.4	5.8	2.5	7.1	7.7	
1977-----	5.3	7.1	6.5	.4	7.1	7.0	
1978-----	4.4	8.1	7.6	.5	8.2	6.0	
1979-----	2.3	8.4	11.5	-3.1	9.1	5.8	
Alternative I:							
1980-----	.0	10.0	14.3	-4.3	10.8	7.0	
1981-----s---	2.2	11.3	10.4	.9	10.5	7.3	
1982-----	4.8	11.0	8.6	2.4	9.4	6.6	
1983-----m-----	5.0	9.3	7.3	2.0	8.1	6.0	
1984-----	4.9	8.5	6.5	2.0	7.5	5.3	
1985-----	4.8	7.7	5.7	2.0	6.8	4.6	
1990-----	3.4	5.8	3.0	2.8	5.6	4.0	
1995-----	3.0	5.25	3.0	2.25	5.6	4.0	
2000-----	2.9	5.25	3.0	2.25	5.6	4.0	
2005 and later---	3.4 ^{d/}	5.25	3.0	2.25	5.6	4.0	
Alternative II:							
1980-----	-.4	9.6	14.2	-4.6	10.5	7.2	
1981-----m-----	.4	9.5	9.7	-.2	9.9	7.9	
1982-----	4.6	10.9	9.0	1.9	9.5	7.3	
1983-----	4.6	9.9	8.6	1.3	9.2	6.6	
1984-----	3.9	9.4	8.2	1.2	8.9	6.2	
1985-----	3.6	9.1	7.8	1.3	8.5	5.9	
1990-----	2.7	8.3	6.5	1.8	8.5	5.0	
1995-----	2.4	7.3	5.5	1.8	7.6	5.0	
2000-----	2.5	6.3	4.5	1.8	6.6	5.0	
2005 and later----	2.8 ^{d/}	5.75	4.0	1.75	6.1	5.0	
Alternative III:							
1980-----	-1.7	9.9	16.6	-6.7	10.5	7.4	
1981-----	-1.0	11.7	13.7	-2.0	10.0	9.1	
1982-----	5.5	11.9	11.0	.9	10.0	8.0	
1983-----m-----	3.9	10.9	10.6	.3	10.0	7.3	
1984-----s-----	3.0	10.4	10.2	.2	10.0	7.0	
1985-----	3.0	10.3	9.8	.5	10.0	6.8	
1990-----	2.1	9.0	8.0	1.0	9.5	6.0	
1995-----	2.3	8.3	7.0	1.3	8.6	6.0	
2000-----	2.2	7.25	6.0	1.25	7.6	6.0	
2005 and later----	2.1 ^{d/}	7.25	6.0	1.25	7.6	6.0	

a/The total output of goods and services expressed in constant dollars.

b/The difference between the percentage increase in average annual wages in covered employment and the percentage increase in the average annual CPI.

c/The average of the interest rates determined in each of the 12 months of the year for special public-debt obligations issuable to the trust funds.

d/The annual percentage increase in real GNP is projected to continue to change after the year 2005 under each Alternative. The values for the year 2055 are 3.4, 2.3, and 0.9 for alternatives I, II and III, respectively.

Table 4-17

SELECTED DEMOGRAPHIC ASSUMPTIONS UNDER ALTERNATIVES
I, II, AND III, 1980 TRUSTEES REPORTS, CALENDAR YEARS
1960-2055

Calendar Year	Total Fertility Rate <u>a/</u>	Age-Adjusted Mortality Rate <u>b/</u>		Adjusted Gross Disability Incidence Rate <u>c/</u>	
		Male	Female	Male	Female
1960	3,608	11.19	9.16	4.73	3.37
1965	2,885	11.09	8.68	4.99	3.56
1970	2,434	10.78	8.00	5.10	3.63
1975	1,770	9.87	7.13	7.59	6.11
1976	1,745	9.73	7.07	7.02	5.49
1977	1,795	9.51	6.85	7.18	5.47
1978	1,775	9.35	6.70	5.70	4.34
1979	1,789	9.19	6.56	5.02	3.82
Alternative I:					
1980	1,833	9.12	6.49	4.95	3.77
1981	1,866	9.05	6.42	4.92	3.75
1982	1,900	8.98	6.36	4.92	3.75
1983	1,934	8.92	6.30	4.93	3.76
1984	1,968	8.85	6.23	4.95	3.77
1985	2,001	8.78	6.17	5.01	3.81
1990	2,171	8.61	6.01	5.21	3.97
1995	2,346	8.45	5.85	5.33	4.05
2000	2,464	8.30	5.71	5.35	4.07
2005 and later . .	2,500	8.22 <u>d/</u>	5.65 <u>d/</u>	5.35	4.07
Alternative II:					
1980	1,803	9.04	6.42	4.97	3.79
1981	1,816	8.91	6.29	5.00	3.81
1982	1,830	8.78	6.16	5.11	3.89
1983	1,844	8.65	6.04	5.22	3.97
1984	1,858	8.52	5.92	5.40	4.12
1985	1,872	8.39	5.80	5.56	4.24
1990	1,942	8.07	5.50	5.98	4.55
1995	2,026	7.77	5.22	6.22	4.73
2000	2,086	7.50	4.97	6.28	4.78
2005 and later . .	2,100	7.36 <u>d/</u>	4.87 <u>d/</u>	6.28	4.78
Alternative III:					
1980	1,758	8.90	6.28	5.02	3.82
1981	1,742	8.64	6.03	5.09	3.88
1982	1,726	8.38	5.79	5.28	4.03
1983	1,709	8.14	5.56	5.53	4.21
1984	1,693	7.90	5.33	5.86	4.46
1985	1,677	7.66	5.12	6.12	4.66
1990	1,598	7.09	4.60	6.75	5.14
1995	1,546	6.58	4.15	7.10	5.41
2000	1,519	6.13	3.76	9.21	5.48
2005 and later . .	1,500	5.90 <u>d/</u>	3.61 <u>d/</u>	7.21	5.48

a/ The number of children who would be born to 1,000 women in their lifetime if they were to experience the observed age-specific birth rates and were to survive the entire child-bearing period.

b/ The number of awards per 1,000 persons exposed to disability, adjusted for changes from the 1977 age distribution.

c/ This value is for the year 2005. Mortality rates are assumed to continue declining during the remainder of the projection period.

Table 4-18

ESTIMATED AVERAGE OLD-AGE, SURVIVORS, AND DISABILITY
INSURANCE TAX RATES, EXPENDITURES, AND ACTUARIAL BALANCE, BY SET
OF ASSUMPTIONS, 1980 TRUSTEES REPORT, 1980-2054

(as percentages of taxable payroll)

Item	25-year averages			75-year average
	1980- 2004	2005- 2029	2030- 2054	1980 2054
Average scheduled tax rate (employer- employee combined).....	11.85	12.40	12.40	12.22
Estimated average expenditures:				
Optimistic assumptions.....	9.91	11.48	12.59	11.33
Intermediate assumptions.....	10.66	13.57	16.98	13.74
Pessimistic assumptions.....	11.73	16.84	26.60	18.39
Difference (actuarial balance):				
Optimistic assumptions.....	1.94	.92	-.19	.89
Intermediate assumptions.....	1.19	-1.17	-4.58	-1.52
Pessimistic assumptions.....	.12	-4.44	-14.20	-6.17

Source: Bartlett, Dwight K. Current Developments in Social Security Financing, Social Security Bulletin, September 1980, p. 17.

ESTIMATED YEAR-BY-YEAR COSTS AND FUND RATIOS OF OLD-AGE,
SURVIVORS, AND DISABILITY INSURANCE PROGRAM UNDER NATIONAL
COMMISSION PROPOSALS

Calendar Year	Expenditures (percent of taxable payroll)	Scheduled Tax Rate <u>a/</u>	Payments from General Revenues <u>b/</u>	Excess of Tax Rate and General - Revenues Payment over Expenditures	Fund Ratio <u>c/</u>
1980	10.99%	10.16%	-	-.83%	25%
1981	11.47	10.70	-	-.77	18
1982	11.52	10.80	-	-.72	10
1983	11.59	12.10	-	-.51	4
1984	11.51	12.10	-	-.59	7
1985	11.54	12.60	-	1.06	12
1986	11.57	12.60	-	1.03	20
1987	11.41	12.60	-	1.19	29
1988	11.29	12.60	-	1.31	38
1989	11.12	12.60	-	1.48	49
1990	10.98	11.20	-	.22	62
1991	10.90	11.20	-	.30	64
1992	10.83	11.20	-	.37	67
1993	10.76	11.20	-	.44	71
1994	10.71	11.20	-	.49	75
1995	10.66	11.20	-	.54	80
1996	10.58	11.20	-	.62	85
1997	10.50	11.20	-	.70	91
1998	10.44	11.20	-	.76	9.8
1999	10.39	11.20	-	.81	106
2000	10.35	10.00	-	-.35	114
2001	10.18	10.00	-	-.18	113
2002	10.02	10.00	-	-.02	113
2003	9.89	10.00	-	.11	114
2004	9.81	10.00	-	.19	115
2005	9.73	10.00		.27	117
2010	9.91	10.50		.59	121
2015	11.01	11.90		.89	114
2020	12.50	13.40		.90	111
2025	13.96	14.80	.45%	.84	109
2030	15.14	15.40	1.40	.26	112
2035	15.59	15.50	1.65	-.09	109
2040	15.45	15.60	1.75	.08	107
2045	15.51	15.60	1.75	.09	108
2050	15.45	15.60	1.75	.15	111
2055	15.60	15.60	1.75	.00	111

a/ Combined employer - employee rate.

b/ Expressed as percentage of taxable payroll.

c/ Assets at beginning of year as percentage of outgo in year.

Table 4-19
(continued)

<u>Calendar Year</u>	<u>Expenditures (percent of taxable payroll)</u>	<u>Scheduled Tax Rate</u> <u>a/</u>	<u>Payments from General Revenues</u> <u>b/</u>	<u>Excess of Tax Rate and General-Revenues Payment over Expenditures</u>	<u>Fund Ratio</u> <u>c/</u>
25-year averages:					
1980-2004	10.84	11.23	-	.39	NA
2005-2029	11.86	12.03	.09	.26	NA
2030-2054	15.48	13.88	1.66	.06	NA
75-year average:					
1980-2054	12.72	12.38	.58	.24	NA

a/ Combined employer-employee rate. The schedule of rates has been developed on the basis that rate increases will occur only in years ending in 0 or 5; it may well be desirable that, in distant future periods, when large increases are shown, smaller increases might be made in other intervening years.

b/ Expressed as percentage of taxable payroll.

c/ Assets at beginning of year as percentage of outgo during year.

NOTE: The estimates are based on the OMB Mid-Session Review economic assumptions in the early years blended into the intermediate long-range assumptions of the 1980 Trustees Reports.

Table 4-20

ESTIMATED YEAR-BY-YEAR COSTS OF HOSPITAL INSURANCE
PROGRAM UNDER NATIONAL COMMISSION PROPOSALS, 1980-2055

<u>Calendar Year</u>	<u>Expenditures (percent of taxable payroll)</u>	<u>Scheduled Tax Rate ^{a/}</u>	<u>Payments from General Revenues!?!</u>	<u>Excess of Tax Rate and General - Revenues Payment over Expenditures</u>
1980	2.14%	2.10%	-	-.04%
1985	2.48	1.35	1.35%	.22
1990	3.24	1.85	1.85	.46
1995	4.01	2.30	2.30	.59
2000	4.71	2.60	2.60	.49
2005	5.29	2.85	2.85	.41
2010	5.29	2.85	2.85	.41
2015	5.60	3.60	3.60	.40
2020	6.21	3.30	3.30	.39
2025	6.92	3.65	3.65	.38
2030	7.58	4.00	4.00	.42
2035	8.00	4.15	4.15	.30
2040	8.12	4.15	4.15	.18
2045	8.04	4.15	4.15	.26
2050	7.92	4.15	4.15	.38
2055	7.90	4.15	4.15	.40
Average, 1980-2054	5.86	3.09	3.00	.23

a/ Combined employer - employee rate.

b/ Expressed as percentage of taxable payroll.

Table 4-21

MAXIMUM EARNINGS TAXED AND PERCENT OF COVERED
WORKERS WITH TOTAL EARNINGS BELOW THE MAXIMUM, PRESENT LAW
AND NATIONAL COMMISSION PROPOSALS

<u>Year</u>	<u>Maximum Earnings Taxed</u>		<u>Percent of Covered Workers with Total Earnings Below Maximum</u>	
	<u>Present Law</u>	<u>Proposal</u>	<u>Present Law</u>	<u>Proposal</u>
1980	\$25,900	\$25,900	91.6	91.6
1981	29,700	29,700	92.7	92.7
1982	32,400*	32,400*	92.6	92.6
1983	35,400*	35,400*	92.8	92.8
1984	39,000*	39,000*	93.2	93.2
1985	42,300*	39,000	93.4	91.6
1986	45,600*	39,000	93.5	89.7

*Based on estimated automatic adjustment on the basis of changes in wages, according to economic assumptions underlying the OMB 1980 Mid-session Review.

Table 4-22
 ESTIMATED ADDITIONAL OASDI BENEFIT PAYMENTS DUE TO PROPOSALS
 OF NATIONAL COMMISSION, CALENDAR YEARS 1982-86
 (in billions)

	Proposal a/ <u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
1. Change limit on family benefits under DI...	\$0.2	\$0.3	\$0.4	\$0.5	\$0.7
2. Raise SGA amount to non-aged earnings-test exempt amount and index in future years...	(b/)	(b/)	(b/)	.1	.1
3. Increase delayed-retirement credits.....	(b/)	(b/)	.1	.2	.4
4. Maintain earnings test to age 72.....	-.4	-.4	-.4	-.4	-.4
5. Suspend student's benefits for months not full-time.....	-.2	-.3	-.3	-.3	-.4
6. Do not terminate benefits in force due to marriage.....	.5	.7	.8	.8	.9
7. Base special minimum benefit on maximum of 35 years, including child-care years...	.8	1.8	2.0	2.2	2.5
8. Universal coverage.....	(b/)	(b/)	(b/)	(b/)	.1
9. All other proposals which affect benefit outgo.....	(c/)	(c/)	(c/)	(c/)	(c/)
Total.....	\$1.0	\$2.2	\$2.7	\$3.2	\$3.9

a/ The proposals are generally effective for January 1982.
 b/ Less than \$50 million.
 c/ Savings or cost for each proposal, and for the sum, is less than \$50 million.

Table 4-23

**ESTIMATED CHANGES IN LONG-RANGE COST AND IN ACTUARIAL
BALANCE OF OASDI PROGRAM UNDER NATIONAL
COMMISSION PROPOSALS**

(as percent of taxable payroll)

<u>I tern</u>	<u>Average Cost for 75-year Period (1980-2054)</u>
Under Present Law^{a/}:	
Average Expenditures	13.80
Average Scheduled Tax Rate	12.22
Actuarial Balance	-1.58
Change in Average Expenditures for Recommended Proposals, Each with Respect to Present Law^{a/}:	
A. Increase normal retirement age gradually to 68	-1.07
B. Elimination of windfall benefits	- .09
C. Change limit on family benefits under DI	+ .06
D. Raise SGA amount to non-aged earnings-test exempt amount and index in future years	+ .01
E. Increase delayed-retirement credits	+ .09
F. Maintain earnings test to age 72	- .01
G. Suspend student benefits for months not full-time	- .01
H. Do not terminate benefits in force due to marriage	+ .03
I. Change method of indexing earnings for widow(er) benefits	+ .05
J. Base special minimum benefit on maximum of 35 years, including child-care years	+ .14
K. Modify automatic benefit increase provisions	<u>b/</u>
L. Coverage requirement for domestics of \$150 per quarter	<u>b/</u>
M. Coverage requirement for casual labor of \$150 per quarter	<u>b/</u>
N. Coverage requirement for self-employed of \$600 per year	<u>b/</u>
O. Eliminate alternative coverage test for agricultural workers	<u>b/</u>
P. Universal coverage	- T-53

Table 4-23 (Cont.)

<u>Item</u>	<u>Average Cost for 75-year Period (1980-2054)</u>
Total Change in Average Cost of Expenditures for Above Proposals, with Interaction Reflected	-1.28
Change in Average Cost of Expenditures for Modifying Earnings Base After Adopting Above Proposals	.21
Total Change in Average Cost of Expenditures for Above Proposals (Including Modifying Earnings Base), with Interaction Reflected	-1.07
Total Estimated Average Cost of Expenditures for System as Modified by Above Proposals	12.72
Average Tax Rate	12.96
Actuarial Balance	.24

a/ Estimates for present-law expenditures and tax rates are based on OMB Mid-Session Review assumptions in the early years, blended into the intermediate long-range assumptions of the 1980 Trustees Reports (see Table 4-4), modified to include the effects of P. L. 96-403, P.L. 96-473, and P.L. 96-499 and to reflect several minor changes in the short-range period.

b/ Cost effect is less than .005 percent of taxable payroll.

NOTE: The taxable payroll for 1981 is estimated to be \$1,258 billion.

SUPPLEMENTARY AND DISSENTING STATEMENTS ON CHAPTER 4

Dissenting Statement on Social Security Financing
By Mr. Laxson, Mr. MacNaughton, and Mr. Rodgers

A major shortcoming of the National Commission's two-year study has been the failure to consider seriously the full implications of the long-term costs of the social insurance system within the context of the whole economy. The thrust of Commission deliberations has been steadily toward responding to social adequacy considerations in the benefit structure, with only peripheral attention to the ultimate cost level. The majority of the Commission has concluded that the scheduling of higher payroll tax rates over the long term, supplemented by a plan for an increasing infusion of funds from the general Treasury, will of itself assure payment of future benefits and restore any deteriorating confidence in the programs.

We believe careful attention should be given to determining at least broadly the level of cost the economy can afford for social insurance, and we strongly oppose the Commission majority's proposed injection of general revenues into the Social Security and Hospital Insurance systems. We concur, however, with the recommended reallocation of the payroll tax rates between the OASI, DI, and HI Trust Funds, the authorization of inter-fund borrowing, and the temporary borrowing of funds from the general Treasury to alleviate the cash-flow problems of the next few years.

As to the short-term financing of Social Security and Hospital Insurance, the Commission report assumes (in accord with its recommendations) the injection of general revenues into the trust funds beginning in 1983. Based on the 1980 Mid-Session Review assumptions of the Office of Management and Budget (OMB), if these general revenue funds were made available, a reallocation of payroll tax income between trust funds plus inter-fund borrowing would maintain the solvency of the system. No borrowing from the general Treasury would be needed and the trust fund balances would increase substantially each year, reaching 68 percent of annual outgo by the end of 1989.

However, under currently scheduled payroll taxes, with no general revenues and no change in benefits or coverage, the same OMB assumptions indicate the combined 3 trust funds would decline to a critical level late in 1983. If new projections this year indicate that economic conditions will be worse than projected in the 1980 Mid-Session Review, borrowing by the trust funds from the general Treasury would certainly be necessary, but with any reasonable improvement in economic conditions beginning in the next year or two, presently scheduled payroll tax increases will permit repayment of these loans at least by the early 1990's.

Therefore, the significantly higher level of income to the trust funds during the 1980% proposed by the Commission majority (to be provided by general revenues) probably is not necessary. Attention should be directed to the long-term financing problem and not to a quick fix which might not prove compatible with long-term needs.

As to the long-term financing, even with the retirement age gradually increased to 68 and the immediate adoption of universal coverage, the combined OASDI-HI cost under the Trustees intermediate assumptions is projected to grow from a 1981 level of 13.3 percent of taxable payroll to 22.1 percent of taxable payroll in 2025 and still higher during the following 15 years.^{1/} Of this total, 18 percent of taxable payroll would be financed by payroll taxes and 4.1 percent by general revenues, according to the Commission majority recommendation, and any costs in excess of this level would be financed entirely by general revenues.^{2/} Roughly one-half of the general revenue portion would be financed by the Commission majority's recommended personal income surtax and the balance by unspecified sources. The 22.1 percent level in the year 2025 would represent a 60 percent increase over current costs. The effect in that year would be equivalent to adding \$103 billion to the estimated \$660 billion fiscal year 1981 Federal budget.

1/ The published Trustees HI cost projections extend only to the year 2004. Projections for later years were prepared for the Commission assuming cost levels will rise only as rapidly as wage levels. In recent years, hospital costs have been escalating much more rapidly than the wage level, and the projections through 2004 assume this will continue.

2/ Details on Table 4-6, Chapter 4.

In addition to the increasing costs of Social Security and Hospital Insurance presently financed by payroll taxes, the National Commission proposes benefit increases in Supplemental Security Income (SSI), Supplementary Medical Insurance (SMI), and Medicaid, all of which are now financed by other than payroll tax sources. The cost of these proposals reaches a level of \$19.8 billion in 1986, the last year for which estimates were made (\$15.3 billion in Federal funds and \$4.5 billion in State and local funds), and the financing of these increases is not dealt with in any way in the Commission report.

The National Commission has followed the Social Security Administration's measurement technique in judging the adequacy of Social Security financing by comparing the relationship of benefit payments to trust fund income over a 75-year period. In light of the major demographic shifts that will occur,^{3/} we believe it more important to concentrate on the level of costs that may ultimately be reached under the proposed coverage and benefit schedule. Table 4-6, Chapter 4, based essentially on the 1980 Trustees intermediate assumptions and geared to maintaining trust fund levels equal to one year's disbursements, illustrates the progression of cost levels to 22.1 percent of covered payroll in 2025 and later up to 23.9 percent. If the retirement age were not delayed to 68, and if universal coverage were not adopted, these cost percentages would approximate 25.8 percent and 27.0 percent respectively.

^{3/}Briefly,, there will be less pressure on the trust funds in the late 1990% and early 2000's, due to the lower birth rate during the depression 1930's. Then, there will be a tremendous surge of retirees resulting from the World War II baby boom.

In recent years, the economy has not performed nearly as well as the assumptions underlying the intermediate actuarial projections, and we believe it probable that future experience will follow this less favorable path.

The following factors, detailed in Tables 4-16 and 4-17, Chapter 4, are suspect in our opinion: the long-run inflation rate, assumed to be 4 percent after 2005; the long-run unemployment rate, assumed to be 5 percent after 1990; and the "real wage differential" (nominal wages minus the inflation rate), assumed to increase to 1.8 percentage points by 1990 and settle at 1.75 percentage points subsequently. In addition, the long-run fertility rate assumed is significantly higher than current rates and may be too optimistic.

In addition, there will be year-to-year fluctuations in economic conditions due to business cycle behavior. Periods of higher inflation and unemployment, perhaps accompanied by negative real wage differentials, as occurred during the 1970's, have severe adverse consequences on the year-to-year cash-flow requirements of the Social Security and Hospital Insurance systems. These cyclical movements are not reflected in long-term projections based on trend line assumptions.

Social Security and Hospital Insurance costs will be higher than indicated in the Commission's report if the intermediate economic and demographic assumptions are not met. For example, if future experience follows a path half way between the Trustees 1980 intermediate and pessimistic assumptions, OASDI-HI costs will approach, or perhaps

exceed, a level of 30 percent of taxable payroll. We are concerned that this level of costs, in addition to the costs of other social insurance programs, may be higher than the workforce will be willing to bear. These large amounts may also have significant effects on personal saving, investment, and productivity.

The National Commission, somewhat belatedly, recognized this aspect in drafting its "Overview" chapter but dismissed the thought with the statement "...the Nation's economy must achieve higher productivity. . . in order that a sound and comprehensive system of taxes and benefits can be maintained." The financing chapter, however, seems not to question that the intermediate assumptions will be met and expresses no concern with the ultimate cost level projected on that basis.

We believe a proper approach to sound management of the Social Security systems involves determining a range of program costs believed sustainable in the long-term. If the existing benefit schedule is deemed too costly over the long run, consideration should be given to possible steps to bring benefit levels within that range. Those steps should include critical review of the benefit structure and its replacement rates, method of indexing, taxability of benefits, the lump sum death benefit and the payment of benefits to spouses and students.

As to the method of financing, given the nature of the total social insurance spectrum with its combination of earned right and welfare aspects, there is no right way or wrong way to fund these programs. However, the payroll tax method of financing OASDI and HI has been

associated over the years with a commitment to fiscal responsibility. Increases in benefits and benefit levels have over the years been covered by payroll tax increases. Proposals for general revenue financing for the most part seem to assume, despite continuing large Federal budget deficits, that uncommitted funds are available for this purpose. The National Commission has moved somewhat toward responsibility by recommending an immediate 2½ percent personal income surtax to offset a part of the general revenue cost of its HI proposal, but has ignored the remainder of this cost and the need to finance its recommended changes in SMI, SSI, and Medicaid. Obviously, the total cost of the program must be financed and changing the source of funding cannot reduce the total requirement.

The majority's proposal calls for an infusion of approximately \$21 billion of general revenues into the HI Trust Fund and an approximate \$9 billion individual income tax surcharge in 1983. The \$12 billion residual apparently would be financed by increasing the Federal budget deficit, thereby adding to inflationary pressures and further reducing the standard of living of the workers who support the program. Under intermediate assumptions, the Commission majority's 18 percent payroll tax cap would be exceeded about the year 2025, at which time general revenues would be injected into OASDI on a gradually increasing basis. To the extent the intermediate assumptions are not met, the cap would be exceeded several years earlier, and the proportion of the total cost of OASDI-HI expected from general revenues would become substantial.

Old-Age, Survivors, and Disability Insurance, with a close relationship to wages and salaries, should in our opinion continue to be financed entirely through the payroll tax. If the Federal budget were in balance and specific provision could be made within the balanced budget, partial financing of Hospital Insurance from general revenues could be supportable. However, under current conditions, any shift to general revenues would merely add to the budget deficit and must be rejected.

Dissenting Statement on Financing Social Security
and Hospital Insurance from Other than Payroll Taxes
By Mr. Myers

I believe that the financing of the social insurance portions of the Social Security Act (Old-Age, Survivors, and Disability Insurance and Hospital Insurance) should continue to be solely from payroll taxes -- and not from any general-revenues taxes, whether or not specifically earmarked. It is true that general revenues are involved in the receipts of the four trust funds established by the Social Security Act, but they do not involve the general financing on a permanent basis of any of the social insurance portions of the program.

As to the Old-Age, Survivors, and Disability Insurance and Hospital Insurance programs, the small portion of the income of the trust funds that comes from the general fund of the Treasury is either for special, small, closed groups of persons or as the matching employer tax with respect to covered employees of the Federal government.

Complete payroll-tax financing of these programs on a long-range, ongoing basis is desirable so as to make the cost apparent and clear to the general public. The injection of general revenues, whether from earmarked taxes or from such general funds as are available, would lead many uninformed persons to believe that "somebody else is paying for their benefits" and would therefore lead to demands for ever-larger benefits.

It is often argued that the OASDI and HI payroll taxes are regressive and bear too heavily on low-income workers, whereas other taxes that might be used for the financing of the program are more progressive. Actually, when both taxes and benefits are considered as a whole, the combination is not regressive, because (1) the tax is proportional up to the earnings base, (2) the benefits are heavily weighted in favor of the lower earners, and (3) the benefits and taxes are the same for all workers at and above the earnings base.^{1/}

^{1/} Perhaps even more importantly in this connection, the incidence of taxes cannot really be accurately measured. Any change in the tax structure will, after a short period of time, be accompanied by a readjustment of the national incomes and remuneration structure. Thus, for example, placing a new tax on employers will shortly result in a reciprocating readjustment of the price and/or wage structure. Similarly, an increase in the income tax rate for those with high earnings will result in a change in the structure of salaries, fringe benefits, and fees of self-employed persons.

Thus, the financing of the OASDI and HI programs by other than payroll taxes will actually result in a shifting of taxes, so that it cannot be said for certain whether the actual incidence of the taxes is significantly different from the impact of increased payroll taxes. As a matter of fact, it cannot really be determined who now actually pays the employer payroll taxes. Some argue that this is borne entirely by the workers through lower wages, while others assert that it is accomplished through higher prices (which, in turn, are paid in large part by the covered workers). In actuality, there is no way of precisely measuring this matter, or even coming close to doing so.

If new taxes are not levied to meet the cost of any general revenues injected into the OASDI and HI programs, this will only add to the budget deficit. The result will be increased inflation, so that the American people will pay for the government subsidy in this manner. Certainly, direct and visible payroll taxes would be a better, more honest way to finance these programs.

The proposal of the majority of the Commission that the payroll tax rates which would be needed to finance the HI program if these were the sole source of financing should be reduced by 50 percent and that such decrease in income should be met from general revenues, beginning in 1983, means that about \$21 billion would be involved in the initial year and increasing amounts each year thereafter. Where will all of this money come from?

The majority of the Commission makes the additional proposal that any increase needed in the payroll tax rate for Old-Age, Survivors, and Disability Insurance and Hospital Insurance above a combined employer-employee rate of 18 percent should be met, instead, from general revenues. This proposal would not be effective for many years (in 2025, according to the intermediate-cost estimate). This is undesirable both for the reasons given previously as to any such form of general-revenue financing and also because no sound reason can be given for such an arbitrary limit. An employee contribution rate of 9 percent would very likely not be unbearable several decades hence if it were gradually approached and phased in -- especially if, despite this, real wages were gradually rising.

The majority of the Commission makes the argument in support of general-revenue financing (which could equally relate to the Social Security cash benefits, which they believe should not be financed in this manner) that the “social costs” relating to social-adequacy features of the program might appropriately be paid for, at least in part, by “society as a whole”. I see little difference between society as a whole and, under universal coverage as the Commission recommends, the covered workers and employers. Accordingly, why move away from the visible, forthright payroll-tax financing procedure to obscure general-revenue or budget-deficit financing?

The Supplementary Medical Insurance portion of Medicare is financed to a significant extent (roughly 70 percent) by payments from general revenues, but this is not a social insurance program, rather being a subsidized voluntary insurance one. As such, it is only natural and proper that there should be financing from a source other than the enrollees, and such other source can only be the general fund of the Treasury.

In summary, then, the whole matter of how to finance the social insurance portions of the Social Security Act comes down primarily to the psychological and public-relations aspects of the situation, rather than actuarial or economic ones. The American public should be economically mature enough to recognize and face openly the costs of these programs, rather than to have them diffused and disguised -- although not decreased -- by having some of them met from other

sources than payroll taxes. The Social Security and Hospital Insurance programs are good ones, and thus necessarily must involve significant costs. Let us face them directly through visible payroll taxes, and not deceive ourselves through partial financing by general revenues.

Moreover, we all must recognize that the general fund of the Treasury does not now have any surplus of monies available to provide any general-revenue financing of these programs. Therefore, any general revenues to finance such payments to the trust funds must come either from new taxes on the taxpayers of the Nation or else by deficit financing, with resultant augmented inflation.

I agree with the supplementary statement by Mr. MacNaughton and Mr. Rodgers that follows this statement.

Supplementary Statement on Financing Social
Security Benefits from General Revenues
By Mr. MacNaughton and Mr. Rodgers

Payroll tax financing is the rock upon which stands the public's confidence in the Social Security and Hospital Insurance systems. The entire package of costs and benefits are out in the open for all to see and understand. This principle should not be breached.

Congress has always had the determination--in fact has required itself by virtue of the payroll tax--to look at the cost side, as well as the benefit side of the equation whenever Social Security and Hospital Insurance matters have been considered. This fact is a cornerstone of the fiscal soundness of the system.

Historically, legislative bodies--particularly State and local--have had a dismal fiscal record in their management of public retirement systems. It would be unfair to fault the individual legislators. Even if they were all wizards of finance, they would be confounded by the manner in which the legislative process is impacted by pension issues and the fact that almost all public retirement systems (other than Social Security) depend on general revenues to a substantial degree.

During legislative activity, pressure for benefits inevitably overwhelms the concern for fiscal sanity. Those who want more benefits are well organized and have an enormous personal stake in the outcome. On the other hand, those who understand what is being done to the general account of the government are usually few and their political power is thinly disbursed. The people who will pay the bill are, in many cases, not yet born. Thus, in a political context, general revenue financing makes it very easy to vote more benefits and very difficult to enforce a fiscal discipline.

Congress should not expose the financial integrity of the Social Security and Hospital Insurance systems to this uneven match-up. General revenue financing removes the politically sobering requirement that payroll taxes be raised to offset new benefits. Several decades of this imbalance have created fiscal nightmares for many State and local governments. Among the several thousands of public retirement systems, only a handful have withstood the inexorable pressure of this imbalance. Few if any, could stand the tests imposed on private pension plans by ERISA.

Thus, in the less than perfect world of legislative management of retirement systems, Congress' conduct of the Social Security and Hospital Insurance systems has been a gratifying exception to the general rule that elected bodies have a difficult time when dealing with retirement systems. Payroll tax financing (Congress' self-imposed requirement that it look at both the cost side and the benefit side of the equation) is the basis of a good record and should be maintained.

Supplementary Statement on Social Security Financing
By Mr. Cohen

During the course of the extensive deliberations by the Commission, the question was raised and discussed several times as to whether the economy could bear the future cost of the present Social Security program. The current high rate of inflation (during which prices have risen faster than earnings) has resulted in pressures to reduce the cost of "entitlement" programs (such as Social Security) so as to decrease governmental spending and the size of the deficit.

As a person over 65 years of age, I am particularly conscious of the adverse impact of inflation on the living standards of older retired persons and particularly the impact of the rising costs of medical services. I do not believe we should make the aged, the disabled, the sick, the widows, and young children bear the costs of the war on inflation. I think the first attack should be on waste, fraud, abuse, and misuse in both the public and private sectors.

The present and the future cost of Social Security, private pensions and related programs are important policy questions deserving careful consideration. The members of this Commission did give thoughtful review to these matters. In my judgment, however, it is not necessary or desirable to make far-reaching legislative reductions in the Social Security program at the present time based upon assumptions and expectations that the cost of the system is currently or will be unbearable twenty to fifty years from now. This expectation is based upon assumptions which may not occur. I concur in the statement by seven members of the Advisory Council on Social Security that the official financial projections overstate the long-range cost of the Social Security system. (Report of the 1979 Advisory Council on Social Security, pp. 216-217).

I also believe that any change in the Social Security retirement age should await further consideration of the impact on private retirement plans, the prospects of employment of older persons, and the ability of the economy to adapt to changing demographic characteristics. It may well be that, for instance, solar/fusion energy sources by the year 2030 may change the entire outlook on the relation of costs of existing programs to resources. I do not know the answer to this matter, but neither do those urging prompt action now to reduce Social Security costs in the future. I suggest that we not extrapolate current unfavorable economic conditions permanently for the long-run future as the basis for making basic changes in the Social Security system.

Nevertheless, I believe we must as a Nation make serious efforts to increase savings, investment, and productivity, among other reasons, in order for our economy to handle both the public and private plan costs for basic entitlement programs. I believe that our economy has tremendous underlying strengths which will make it possible to meet our future entitlement commitments. In any case, I think we should not rush into far-reaching and controversial changes in the basic entitlement aspects of the Social Security program until after the most urgent and immediate steps are taken to restore the financial soundness of the program, reaffirm the integrity of the present benefit replacement structure and after a full opportunity for examination by Congress of future economic developments in relation to the Commission's retirement age and indexing recommendations have been canvassed and understood by the American public. I do not believe a majority of the American public currently favor either proposal. I am deeply concerned that adoption of such proposals could be a major risk to continued public confidence in the contributory Social Security system and to the public's confidence in the Congressional oversight and management of the system. I think Congress should ascertain the public response to these implications before proceeding to endorse these modifications of a sensitive national institutional entitlement. The public concern and confusion which greeted a proposal to tax Social Security benefits should be an indication of how a proposed basic change in the law can precipitate widespread opposition and potentially undermine public confidence in the system.

I have faith in the possibility of further technological and productivity improvements in our economy which would result in a continued long-run increase in our Gross National Product. Consequently, I believe the future cost of Social Security will be a reasonable one in relation to the future increased Gross National Product. This relationship is frequently overlooked by those who extrapolate current low rates of productivity into the long-range future. (For projected percentage of Gross National Product see Long-Range Cost Estimates for Old-Age, Survivors, and Disability Insurance System, 1980, Actuarial Study No. 83, September, 1980, pp. 73-74, U .S. Department of Health and Human Services, Social Security Administration, Office of the Actuary.) For the long-run, I believe we should not adopt the pessimistic assumptions as the basis of major policy decisions today.

One justification given for increasing the Social Security retirement age is the expected future increase in the proportion of the aged in the population. This fact overlooks, however, the possible decrease in the proportion of young persons in the population who have to be supported by the working population. The total dependency population should be considered in relation to future costs. (See United States Population Projections for OASDI Cost Estimates, 1980, Actuarial Study No. 82, June, 1980, pp. 45-47. U .S. Department of Health and Human Services, Social Security Administration, Office of the Actuary.)

Current estimates do not indicate that the total dependency ratios justify precipitate action on the retirement age from the standpoint of

total costs to the economy or the impact on the working population.

Future total dependency costs should be periodically reexamined before a major public policy decision is made on retirement age solely on the basis of future costs of the aged.

I would urge the Secretary of Health and Human Services and the Congress to review these considerations before making fundamental changes in the basic Social Security system.