

Statement of
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The views in this statement are those of the author and do not necessarily reflect the views of the Employee Benefit Research Institute, its Trustees, members, or other staff.

Mr. Chairman, I am pleased to appear before you today to discuss the current deliberations on Social Security financing. I appear today in my capacity as Research Director of the Employee Benefit Research Institute. EBRI is a nonprofit organization dedicated to providing research and analysis which can serve as the basis for sound policy toward employee benefits. EBRI as an institution does not take positions on public policy issues. Prior to joining EBRI, I served as the Deputy Director of the Office of Policy Analysis in the Social Security Administration. Prior to that I was Deputy Research Director of the Universal Social Security Coverage Study, a study mandated by Congress in 1977.

I have recently written, and EBRI has published, a book entitled Social Security: Perspectives on Preserving the System that focuses on the evolution of Social Security in this country, its current financing problems, and the prospects for the future. The analysis looks at Social Security in the framework of the larger retirement income security system in this country. While my analysis touches on many aspects of the issues surrounding Social Security today, I will focus primarily on two issues: first, the expansion of coverage to include new federal workers in the future, and second, Social Security's long-run financing situation.

SOCIAL SECURITY COVERAGE FOR FEDERAL WORKERS

The proposal by the National Commission on Social Security Reform to cover federal workers will likely create more controversy than any other element in the package. It is the only recommendation in the package being

attacked in a coordinated media campaign.

There are three principal reasons generally cited for extending Social Security coverage to workers now exempted from participation. These are: (1) inadequate income protection for persons not covered by Social Security; (2) inequities inherent in partial exemption from participation in a mandatory redistributive program; and (3) subsidized benefits afforded partial participants in Social Security.

Inadequate Protection for Persons Not Covered -- Most workers not covered by Social Security are covered by pension plans sponsored by their employers. Both Social Security and the typical pension plan require a period of employment under the retirement program before the worker is eligible for insurance protection. As a result, workers who have jobs not covered by Social Security or who shift between covered and noncovered employment may experience periods without disability and survivor coverage.

Public pension plans usually require at least five years of service before the worker receives disability protection. Many employees in the initial five years of service are young people holding their first major jobs who have no other pension protection. Although disability is unlikely for most young workers, it does occur and the worker is often without insurance or assets.

Workers who leave federal employment without CSRS annuity status, for example, are the least likely to have Social Security coverage and are the most likely to need it. Of workers who left federal employment between 1973 and 1977, an average of 39 percent of the men and 63 percent of the women were not insured against disability.

Workers in employment not covered by Social Security also experience

gaps in benefits. These gaps arise because many of the alternative pension systems do not provide disability and survivor benefits comparable to those provided by Social Security. A twenty-one-year-old worker can acquire Social Security disability protection with credited earnings for six quarters of work in covered employment; in fact, these credits can be earned with as little as one month of covered employment in two consecutive years. To become insured under CSRS, the same person would have to work five years for the federal government.

Inequities Inherent in Exemptions from Participation in a Mandatory Redistributive Program -- Career noncovered workers are exempted from paying into an income-redistributive program that provides proportionately more generous benefits to low-wage than to high-wage workers. Part of the payroll tax contributions of high-wage covered workers is used to provide more generous benefits to retirees with low average lifetime earnings than they would otherwise receive if Social Security were not tilted to favor low-income workers. The highly paid noncovered worker does not share this burden. There is nothing inherently different in the employment of noncovered workers that differentiates their work from that of noncovered workers. There are accountants, lawyers, economists, actuaries, blue-collar workers, clerks, and secretaries in both the covered and the noncovered sectors. The only distinction is that some workers are employed by employers who do not participate in the system.

It should be kept in mind, however, that some noncovered employees are low-paid workers who would actually benefit from expanded coverage. Women, for example, would benefit from wider Social Security coverage. Approximately 28 percent of women employed by the federal government in April 1978 had annual

salaries below \$10,000, whereas only 7 percent of the federally employed men did. Conversely, only 8 percent of the Federally employed women had salaries above \$20,000 in 1978, whereas 31 percent of the men did. Similarly, members of minority groups would benefit from the redistributive aspects of Social Security. Only 12.9 percent of the whites employed by the federal government had annual salaries below \$10,000 in April 1978, but 19.4 percent of minority group employees did. In comparison, 11.6 percent of minority federal workers has salaries exceeding \$20,000 per year, while 37.5 percent of white Federal workers had such salaries in April 1978.

It is the redistributive aspect of Social Security that also gives rise to the third set of problems which many people believe constitutes the most important inequity resulting from the current pattern of Social Security exemptions.

Benefits Afforded Partial Participants in Social Security -- Workers with periods of noncovered employment who qualify for Social Security benefits receive higher benefits in proportion to their contributions to Social Security than do workers with only covered employment. It is important to understand that although this difference is quantifiable, the issue is still highly emotional and controversial. Language must be selected carefully so that the issues are not obscured by rhetoric.

Frequently, people who have a favorable ratio of benefits to contributions from Social Security because of periods of noncovered employment are characterized as "double dippers." The attribution is misleading and brings a perjorative tone to the discussion. Both the description and the policy solutions that have been put forward to solve the "double dipper" problem reflect a lack of understanding of the problem or of potential effective solutions.

"Double dipping" suggests receiving dual compensation or benefits based on one period of service. For people who work in noncovered employment, there is little double attribution of service both to a noncovered pension system and to Social Security. Dual beneficiary status occurs because recipients have complied with mandatory provisions under both covered and noncovered employment. While working in noncovered employment they contributed to their pension plan and became eligible for benefits. While working in covered employment they contributed to Social Security and met the eligibility requirements for a Social Security benefit as well. Many of those who receive preferential treatment from Social Security because of noncovered employment receive absolutely no retirement benefits from the noncovered employer's pension plan.

A more appropriate description widely used in the literature characterizes the relatively generous payments to people with periods of noncovered employment as "windfall benefits." The Universal Social Security Coverage Study characterized the windfalls as "unintended subsidies." Historical Congressional concern about unintended subsidies dates back to 1939 when the House of Representatives' Report on the Social Security Act Amendments of 1939 stated:

An average wage formula will also have the effect of raising the level of benefits payable in the early years of the system, but it will reduce future costs by eliminating unwarranted bonuses payable under the present formula to workers in insured employment only a few years. These bonuses are justified, if a total wage formula is used, in the case of older and low-paid workers who retire in the early years of the system and have not had time in which to build up substantial benefit rights. In the long run, however, such bonuses are unwise and endanger the solvency of the system by

permitting disproportionately large benefits to workers who migrate between uninsured and insured employment and accumulate only small earnings in insured employment. 1/

The Universal Social Security Coverage Study, which was mandated by the Congress as part of the 1977 Social Security Amendments, quantified the costs of these unwarranted bonuses from Social Security. The estimate is that the total bonuses exceed \$2 billion per year. These are costs incurred by Social Security and borne by the taxpayers who contribute to the program. While another recommendation by the Commission would reduce these windfalls over time, extending coverage to new federal workers would help to ameliorate the problem more quickly.

Implications of Covering Federal Workers

Several of the organizations that represent federal civilian and postal workers have begun a full-scale attack on the proposal to cover new Federal workers under Social Security. In each instance, the presentation distorts the facts pertinent to the consideration of this proposal made by the National Commission on Social Security Reform. These presentations make three basic points.

First, they allege that without new contributions the Civil Service Retirement System (CSRS) would go bankrupt and taxpayers would have to shoulder the burden. The inference is that employee contributions assure the solvency of the CSRS -- dry them up and benefits cannot be paid. The fact is that if employee contributions were the only source of income to CSRS the fund would be depleted by 1987 or 1988 at the latest. Even if the system operated in

1/ House of Representatives, 76th Congress, First Session, Report no. 728, Social Security Act Amendments of 1939 (June 1, 1939), p. 10.

the fashion that many federal workers believe (i.e., employee contributions plus a matching agency contribution plus trust fund interest) the fund would be depleted sometime between 1993 and 1995. The fact of the matter is that the current CSRS is primarily dependent on taxpayer support on whatever basis the cost of the system is considered.

There are those who argue that taxpayer support is now required because of past imprudence: massive liabilities (i.e., benefit promises) were accumulated but never funded. The National Federation of Federal Employees argues that "the unfunded deficit originated because the federal government failed to pay its share into the fund from 1920 to 1956." It is not clear what the government's "share" was during this period but employee contributions net of refunds were only one-quarter of one billion dollars more than government appropriations and contributions for the period 1920 to 1955. The total unfunded liabilities of the CSRS at the end of 1955 were less than \$10 billion. By comparison, of the roughly \$500 billion in unfunded benefit promises on the CSRS books at the end of fiscal 1981, nearly one-quarter (23.8 percent) arose during 1980 and 1981. The growth in the CSRS unfunded liability in 1980 and 1981 was more than 10 times the total accumulation of unfunded liability over the first 35 years of the program's existence. It is clear that the current CSRS is largely dependent on taxpayer support to meet current benefits payments; it continues to accumulate added liabilities for future generations of taxpayers as well.

The second point that opponents of expanded Social Security coverage argue is that covering new federal workers will mean higher future budgetary costs for federal retirement. The budgetary cost of the CSRS can be

described by the following simple formula: 2/

$$(1) \text{ CSRS Budgetary Cost} = \text{benefits plus refunds minus} \\ \text{employee contributions.}$$

If new federal workers are covered under Social Security and a supplemental pension is established the implications for taxpayers will depend on several factors. In order to show the budgetary impact of covering new Federal workers under Social Security and a modified pension I have analyzed and will discuss a proposal that captures the essence of a bill (S2905) introduced by Senator Ted Stevens (R. Alaska) during 1982.

Senator Stevens' bill called for Social Security coverage coordinated with a modified federal pension for new Federal employees beginning in 1983. That is the implementation year used for this analysis; using 1984 as the first year would not significantly change the analysis or results. The analysis here breaks the ongoing costs of the total system into two components: (1) the ongoing costs associated with the closed system that would apply to old hires, and (2) the costs of the new system covering future employees. The budgetary costs of the separate systems can then be aggregated to get the combined system's cost.

The total budgetary impact of modifying CSRS is different from the effect on the various accounts taken separately. Both CSRS and Social Security are now within the unified budget. Segregating the old and new systems, the costs for the various accounts can be considered as follows:

2/ See Sylvester J. Schieber, The Cost and Funding Implications of Modifying the Civil Service Retirement System (Washington, D.C.: EBRI, 1982) for a complete discussion of the derivation of these estimates.

- (2) Closed CSRS Costs = benefits (old) plus refunds minus employee contributions.
- (3) New CSRS Costs = benefits (new) plus refunds minus employee contributions.
- (4) Social Security Costs = benefits (SS) minus employee contributions.
- (5) Total Budget Cost = old CSRS cost plus new CSRS cost plus Social Security cost. 3/

Equation (2) is essentially the same as equation (1) discussed earlier, which applied to the current system. The difference is that equation (2) applied only to those workers on the payroll or persons entitled to CSRS benefits (receiving or deferred) on the assured date the modified system would be put into operation. Equation (1), in contrast, assumed that future new workers would continue to be covered under the current system. Equation (3) represents the budgetary cost of the new federal retirement program.

Equation (4) shows the budgetary effects of Social Security coverage of new hires. The budgetary effect is different from the effect of the OASDHI accounts, in that the specific account would be credited for both employer and employee contributions. Since Social Security is in the unified budget, the employer contribution would show up as an expense in the agencies' budgets and as equal trust fund income in the Social Security accounts. The two would cancel each other out.

The total budgetary costs, modifying CSRS as considered here, can be calculated according to equation (5) and compared with the cost of the current system derived on the basis of equation (1). Table 1 shows the projected

3/ See Sylvester J. Schieber, *The Cost and Funding Implications of Modifying the Civil Service Retirement System* (Washington, D.C.: EBRI, 1982) for the detailed projections of the component elements of each of these equations.

TABLE 1

FEDERAL AGENCY AND GENERAL REVENUE EXPENDITURE PROJECTIONS
 FOR THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM AND
 MODIFIED SYSTEM IN CONJUNCTION WITH NEWLY HIRED WORKERS
 UNDER SOCIAL SECURITY, SELECTED YEARS 1983-2050

Year	Current System (billions)	Modified System (billions)	Net Savings (billions)
1983	\$ 17.9	\$ 17.7	\$ 0.2
1984	20.0	19.9	0.1
1985	22.4	22.2	0.2
1986	24.3	24.1	0.2
1987	26.3	26.1	0.2
1988	28.4	28.1	0.3
1989	30.3	30.0	0.3
1990	32.3	31.7	0.6
1991	34.2	33.7	0.5
1995	42.4	41.6	0.8
2000	54.5	54.7	-0.2
2005	70.8	68.1	2.7
2010	93.2	86.1	7.1
2015	122.4	102.9	19.5
2020	161.9	130.8	31.0
2025	212.6	167.3	45.3
2030	277.7	211.8	65.9
2035	360.0	273.6	86.4
2040	465.7	360.3	105.4
2045	604.1	499.2	104.9
2050	786.7	683.6	103.1

SOURCE: Sylvester J. Schieber, The Cost and Funding Implications of Modifying the Civil Service Retirement System, (Washington, D.C.: EBRI, August 19, 1982). Tables 2,6,and 8.

budgetary cost of the current system and the proposed modified system and the net differences. Based on the projections, moving to the modified system on January 1, 1983, would reduce the budgetary costs of federal retirement by \$1 billion over the first five years. While the cost savings during the early years would be moderate in relative terms, the actual numbers that would show up in the unified budget might be affected by moving accounts in or out of the budget. This would not affect taxpayer costs for federal retirement.

The Stevens bill would require coverage of newly hired workers and offer incentives for current workers to move to the new system. The savings from modifying CSRS in accordance with this proposal would grow significantly after the turn of the century as the federal work force becomes predominantly covered by the new system. Ultimately, the savings would grow to nearly one-quarter of the current system's projected cost. The net savings estimates of moving to the modified system do not include any savings that could be realized if Social Security windfall reduction provisions for old hires were implemented.

In sum, modifying the CSRS along the lines of the Stevens proposal would result in significant budgetary savings over both the short and long term. Coverage of new hires under Social Security would maintain the level of employee contributions for retirement purposes. In a budgetary sense then, any proposal coupled with Social Security coverage that just maintains or does not increase total federal retirement benefits cannot cost the taxpayers more than the current system.

The third point opponents of Social Security coverage of federal workers argue is that such a policy would ultimately raise Social Security costs. There has never been a set of cost estimates by any of the responsible parties involved that shows the net cost of Social Security rising as a result of covering federal workers. Wishing that the numbers showed such a cost increase or merely saying it, does not make it so. In fact, the estimates by the Social Security actuaries have consistently shown significant short-and long-term savings for other payroll taxpayers if federal workers are covered under Social Security.

THE LONG-RUN DEFICIT

Historically, Social Security policy has attempted to balance the countervailing goals of adequacy and equity through its financing and benefit structure. Until recently, this process has been relatively uncontroversial because virtually all beneficiaries have received, or could expect to receive, benefits that substantially exceeded the value of their contributions. The days are quickly passing when all members of each retiring group of workers can expect to receive more than the value of their combined employer-employee payroll tax contributions. The future balance of adequacy and equity has to be considered in the framework of a broader set of priorities.

Two equally important policy goals for Social Security are solvency and public support. If these goals are not met, adequacy and equity considerations will become moot. Questions about Social Security's solvency have shaken the confidence of old and young alike. Without confidence that it is solvent, support for the program will wither.

Intergenerational concerns about Social Security link the short- and long-term considerations. Policymakers cannot seek solvency with total disregard for either adequacy or equity. There is general agreement across the entire political spectrum that retirees must not be ravaged by program modifications. At the same time, the national commitment to the income security of the elderly must be perceived as a burden equitably shared by all elements of society.

The most prevalent perception of young participants in Social Security today is that they will never get benefits from the program. Virtually all of the long-term savings in the Commission's recommendations are by-products of

their short-term proposals. The implications of the long-term funding deficit cannot be expected to instill public confidence that the National Commission on Social Security Reform has come to grips with a fundamental problem in the program. If Congress fails to address this problem support for Social Security can only erode further as the short-term adjustments are implemented and the coming Hospital Insurance financing crisis approaches.

Before making any decisions about changes to Social Security that might help to resolve the long-term deficit it is important to consider the underlying implications of alternative policies. There are two basic approaches for eliminating the long-term deficit: raising additional revenues or slowing the growth in outlays.

Raising additional revenues through the payroll tax or alternative sources would help resolve the projected problem. To raise revenue sources now to the extent required to balance the system over the long term could cause massive trust fund accumulations during the 1990s. Unless provisions are made to handle those trust funds, raising taxes might create even more problems. To merely schedule future tax increases sufficient to meet the long-term problems would be to levy on today's children and those not yet born a burden that current or prior generations have been unwilling to bear. Will future taxpayers be willing to accept that burden? Maybe they will; possibly they won't.

Some analysts will point to several public opinion polls that have been taken in recent years indicating a greater public willingness to accept higher Social Security taxes rather than benefit reductions. It is not clear what these polls are telling us, however. In a recent Washington Post - ABC News poll 58 percent preferred raising taxes to 21 percent selecting benefit cuts as

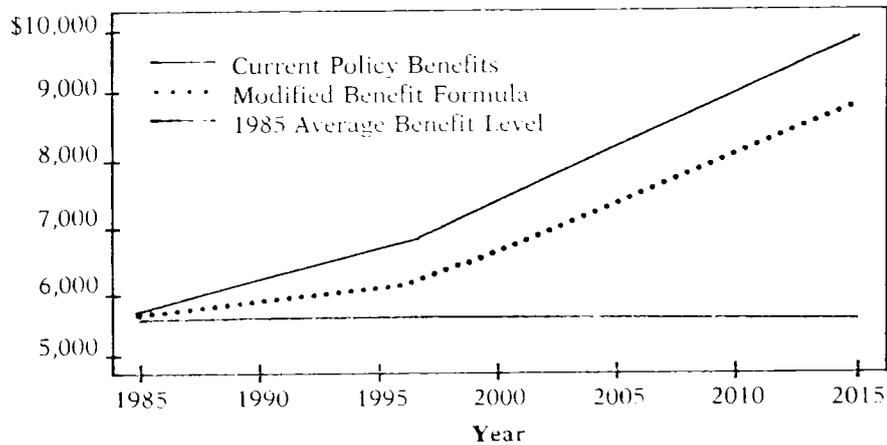
the way to resolve the Social Security financing problem. But in evaluations of specific recommendations by the National Commission the story was much different. On moving the 1985 scheduled payroll tax increase to 1984, 39 percent favored the recommendation; 55 percent opposed it. On increasing the self-employed payroll tax rate 40 percent favored while 51 percent opposed the increase. When asked about delaying the July 1983 cost of living allowance (COLA) adjustment to January 1984, on the other hand, 52 percent favored this policy while 43 percent opposed it. On the Commission's proposal to tax Social Security benefits 46 percent favored while 49 percent opposed it. With the exception of the latter item, where the responses were within the 3 percent sampling error range of being evenly split. Each of the particular responses was inconsistent with the overall assessment that taxes should be raised rather than benefits reduced. 4/

It is not clear what people perceive when they are confronted with questions related to benefit reductions. The various long-term options that would adjust the normal retirement age in Social Security or gradually reduce the rate of earnings replacement are widely characterized as benefit reductions. This interpretation is only partially correct. What is not always understood is that there is inherent growth built into the Social Security benefit structure that will increase the purchasing power of average benefits in the future. For example, figure 1 shows the growth in average benefits under the current policy simulation in 1982 dollars as the solid upper line. The broken lower line in the figure shows future average Social Security benefit levels under an option that would slow the growth of initial benefit

4/ Barry Sussman, "Social Security Plan Splits Public Opinion." The Washington Post (January 27, 1983) p. A4.

FIGURE 1
Future Average Family Social Security Benefits
at Age 65

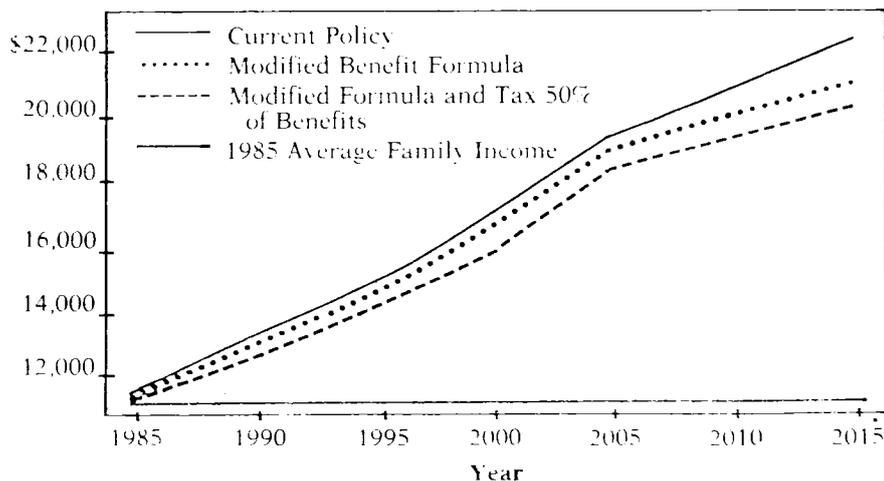
In 1982 Dollars



Source: Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, D.C.: EBRI, 1982) p. xxxi.

FIGURE 2
Future Average Disposable Family Income at Age 65

In 1982 Dollars



SOURCE: Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, D.C.: EBRI, 1982) p. xxxii.

levels through a modification of the benefit formula.

The adjustment to the benefit calculation procedure considered here, for the sake of discussion, would begin in January 1984 and would index the benefit formula "bend points" by 75 percent of wage growth instead of the full wage indexation that is now used to adjust the formula annually. This procedure would be continued for sixteen years under the II-B assumptions used in the 1982 Trustees' Report although a shorter or longer period could be used depending on actual economic experience. The net ultimate effect of this benefit formula modification under the II-B assumptions would be to reduce average Social Security benefits by about 11 percent, when compared with the current policy benefit levels. Yet, over the period, average benefits would continue to grow steadily.

This option can be perceived as providing a real cut in benefits only if the benefits for potential retirees decades hence under the current policy are considered to be firmly committed. It is tenuous to assure that the exact level of Social Security benefits to be paid ten, twenty, or thirty years from now is broadly perceived as that firmly committed. The most important commitment should be to assure that the benefits will be there when people need them and that those benefits will provide a reasonable base of support for the elderly's retirement income security.

COMPARING THE ALTERNATIVES

Setting any retirement age in a national program the magnitude of Social Security is somewhat arbitrary. The establishment of age sixty-five in 1935 as Social Security's retirement age was basically a normative decision. The same can be said about the other facets of the program as well, from the benefit structure to the financing provisions. The prospect facing Congress

now is a new set of normative options, all of which somewhat change the course from the accumulation of past decisions. It is possible that if Congress were presented with a clean slate, it might design a program significantly different from the one now known as Social Security. But Congress does not have a clean slate; there is a defined structure with an inherent set of obligations. Congress faces the choice between making a set of incremental adjustments or more radically restructuring the existing system.

In our work at EBRI we have compared the implications of various long-run options using a computer model that simulates people's work careers and retirement lives. 5/ In the analysis we compared the effects of five options by calculating the present value of Social Security benefits based on the simulated life beyond age sixty-two, under each of the options. We calculated the stream of annual benefits paid each year that a person lived beyond age sixty-two; this calculation included not only worker benefits but spouse and survivor benefits as well. Each benefit was attributed to the person to whom it would be paid; that is, a spouse benefit was attributed to the spouse, not to the primary beneficiary on whose benefit the spouse was based. Annual benefits were calculated in 1982 dollars and discounted by a 2 percent real rate of return back to age sixty-two to give the value of lifetime benefits that would be paid to all persons who reached early retirement age under current policy for each of the policy options that was simulated. The value of benefits under each of the alternative policy options was then compared with the value under the current policy option, and the percentage

5/ For a complete description of this analysis see Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, D.C.: Employee Benefit Research Institute, 1982).

change in benefits was calculated. Table 2 shows the results of these calculations for all individuals in the cohort of workers aged twenty-five to thirty-four in 1979. To limit the complexity of the analysis, only one cohort is shown. This cohort was chosen because these people would feel the maximum effect of each of the options simulated.

From a lifetime-benefits perspective, the distributional effects of the various options are quite different. The options that adjust the benefit formula (i.e., bend point adjustments) tend to cluster the benefit reductions, relative to current policy, below 15 percent. Under the price indexing of earnings options, benefit reductions for the majority would also be less than 15 percent. Under each of these options there is a clear modal group with narrowly distributed benefit reductions being spread across a wide range of the population. Under these options, almost everybody ends up in roughly the same boat, so to speak. The variations in the distributions that exist from the alternative formula adjustments stem from variations in work and earnings patterns in the simulations.

Under the scenario for raising both the normal retirement and early retirement ages, about 34 percent of the people had benefit reductions of less than 5 percent. In fact some people with long lives beyond age sixty-eight, who worked to normal retirement age under both simulations, would receive higher lifetime benefits under the higher-retirement-ages scenario. This occurs because their benefits would be calculated on the basis of a PIA formula whose bend points had been indexed three additional years. About 23 percent of the people at the upper end of the distribution would experience benefit reductions of 25 percent or more under this option, while 10 percent would lose benefits altogether. The wider distribution of benefit reductions from raising

TABLE 2

DISTRIBUTION OF RELATIVE CHANGE IN PRESENT VALUE OF LIFETIME SOCIAL SECURITY BENEFITS AT AGE 62 UNDER ALTERNATIVE POLICY SCENARIOS IN COMPARISON WITH BENEFITS UNDER CURRENT POLICY FOR PERSONS AGED 25 to 34 in 1979

Relative Reduction in the Value of Lifetime Benefits Compared with Benefits Under Current Policy

Policy Option	(Percentage of persons in each category)										Total a/
	Less than 5 Percent	5 to 9.99 Percent	10 to 14.99 Percent	15 to 19.99 Percent	20 to 24.99 Percent	25 to 99.99 Percent	100 Percent				
Bend-point indexation by 75 percent of earnings for 16 years	2.1	26.7	69.8	0.8	0.3	0.3	0.0	0.0	0.0	0.0	100.0
Price indexation of bend points	1.7	14.0	62.3	22.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
Price indexation of wages indefinitely	3.5	64.8	25.7	4.8	0.6	0.5	0.0	0.0	0.0	0.0	100.0
Raising early and normal retirement ages three years	33.9	27.8	7.8	5.6	2.5	12.7	9.9	0.0	0.0	0.0	100.0
Raising normal retirement age three years and adjusting actuarial factors	7.0	7.0	12.3	48.6	19.2	4.4	1.5	0.0	0.0	0.0	100.0

SOURCE: For a complete description of this analysis see Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, D.C.: Employee Benefit Research Institute, 1982), p. 196.

a/ Totals may not add to 100 percent in all instances because of rounding.

the retirement age compared with the distribution under the options for modifying the benefit computation, stems from later retirement age eligibility in combination with age at death. Even though average life expectancy increases over the simulation period, some people still die between the ages of sixty-two and sixty-five and sixty-five and sixty-eight. People who do not live to age sixty-five or who live only a few years into retirement would receive benefits for a shorter period under this option. Obviously, their lifetime benefits would be reduced significantly.

The option that raises normal retirement age but maintains the current early retirement age would lead to somewhat larger benefit reductions on average than any of the other options. This occurs because people are expected to choose to retire at an age close to the retirement age under current policy, at the expense of the larger actuarial reductions in their benefits. If older workers were to extend their careers in the future, however, this phenomenon might be less extensive than the simulation suggests. The size of the baby-boom cohort and the prospects of the mass exodus of these people from the work force might result in significant wage growth among the members of this cohort as they begin to retire. To some extent, this phenomenon is captured in the simulation, but possibly not sufficiently. If the wages of this cohort were to rise appreciably as the group approached retirement, the labor-force participation of the elderly could be expected to rise and the Social Security benefit reductions would be less pronounced than the simulation results shown in table 2 suggest.

It is also important to remember that there are other sources of income that will help to mitigate the effects of modifications in Social Security. By the time any of the long-term options being seriously discussed is fully

implemented, the portion of the elderly's population receiving pension and IRA annuities will be significantly higher than is currently the case. Figure 2 shows the estimated average disposal income for future cohorts of retirees from our simulations under three different Social Security policy scenarios in 1982 dollars. The top line in the figure represents estimated average disposable family income under current Social Security policy. The middle line shows the projected path of average income under the Social Security benefit formula modification that would slow bend-point growth to 75 percent of wages for a defined period. The bottom line shows the projected path if the formula were modified and half of Social Security benefits began to be treated as regular income. The difference between the current policy and the combined alternatives may be considered as an 8 percent reduction in income at age sixty-five by the year 2015. Another way of expressing the difference is to say that under current policy, average real disposable income is projected to rise by 1.9 times between 1985 and 2015, whereas it might go up only 1.8 times under the modified policy.

The combined effects of modifying the formula plus treating half of benefits as regular income would close at least 90 percent of the projected long-term deficit in the Social Security cash benefit programs. This particular set of options has been chosen not to represent a preferred policy option, but rather to put the discussion in a proper context. Each of the other options considered would have distributional results somewhat different from those associated with this particular option, but most would not be significantly different in the aggregate.

OTHER CONSIDERATIONS

There are certain facets of the package submitted by the National

Commission on Social Security Reform that warrant further consideration. The provisions for taxing benefits would introduce a "notch" such that in certain instances, an added dollar of non-Social Security income will result in significant reductions in disposable income. Such a policy would appear to have inherent inequities. It is our understanding that subcommittee staff is aware of this problem and is devising a legislative package that includes a more equitable provision.

Finally, the proposal to subject contributions to cash or deferred arrangement (CODA) plans set up under S401(k) of the IRS code may be inconsistent with other general and FICA taxing policy. Given that there has been absolutely no analysis of the revenue effects of this proposal or its potential implications on the distribution of ultimate benefits such a policy may deserve additional scrutiny.

CONCLUSION

Our analysis suggests that the future of the retirement income security system may not be so dismal as a narrow focus on Social Security's current financing projections would suggest. While no one can predict the future with great accuracy, some trends can be observed and their outcomes predicted. For example, American society is aging and it will continue to do so. In addition, pensions and private retirement savings are growing in importance as sources of retirement income security and they will continue to do so in a favorable policy environment. Although the aging of society is bound to put extra stress on Social Security, the growth of pensions can help to relieve some of that burden.

If Social Security is to remain the cornerstone of our retirement system, it must adjust in the future to meet the changing needs of society.

The uncertainty of the extent of changes in the economy, productivity, birthrates, life expectancy, and a host of other factors suggests that Congress should adopt a Social Security policy that allows some margin for error. In essence, this means that any policy changes Congress makes in the current environment should not promise more cash benefits for the future than we are sure we can provide. This is especially the case given the pending financing problems of the HI program. This raises the possibility that adjustments made today may have more drastic effects or provide greater program savings than future generations would accept. For example, if it is socially desirable to raise the level of real Social Security benefits in the future it can be accomplished through the legislative process at that time. The public would then have a much clearer understanding of the needs of the elderly population and the relative burden that Social Security financing will place on workers. One has to assure that future Congresses will be equipped to assess appropriate benefit and taxing provisions in their respective times. Policymakers then will be better able to judge the relative needs and capabilities of their society and economy than anyone can judge today.