

*Statement of*  
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*before the*  
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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, Social Security's long-run financing situation, and second, the expansion of coverage to include new federal workers in the future.

#### LONG-RUN CONSIDERATIONS

The package of Social Security policy modifications that are now before the Congress move significantly toward restoring the short-term financial balance of the Social Security cash benefits programs. Yet the public opinion

polls that have been taken since the package of recommendations has been completed by the National Commission on Social Security Reform show persistent widespread skepticism about the long-term viability of the program. The members of the National Commission, while agreeing that provisions saving 1.80 percent of taxable payroll were needed in the long run, only recommended modifications that would net 1.22 percent. It is clear that the Congress is having difficulty resolving the remaining long-term deficit.

Meanwhile, news is emanating from the Social Security actuaries that this projected 1.80 percent long-term deficit should be adjusted upward to 2.09 percent under current law. The Congress should be aware that the long-term projection process will, in all likelihood, raise the average cost of the system even further in the future. The reason is that the annual cost estimates are generated over a 75 year time horizon. As each year passes, that year is deleted from the projection period and the next 75th year is added. As an analogy, one could think of a locomotive pulling 75 freight cars. At each station the train stops, the front car is taken off the train and another car is added on to the end. If the car that is taken off is lighter than the one added, the burden on the locomotive increases.

This is exactly the phenomenon that is now occurring in the OASDI valuations. For example, on the basis of the Alternative II-B assumptions used to develop the 1982 Annual Trustees Report, the cost of the OASDI program was estimated to be 11.78 percent of taxable payroll for 1982. Under the same assumptions the projected cost for the years 2055 and 2060 were 16.81 percent of covered payroll. The seventy-five year period on which the 1982 long-term estimate was based included the years 1982 through 2056. This year's estimate will include the years 1983 through 2057. The process of considering

*different years will lead to a higher cost estimate. Furthermore, the actuaries have recently adjusted their fertility and withdrawal assumptions, further exacerbating the long-term financing deficit projections.*

*In addition to the long-term problems in Social Security's cash benefits programs there is a more imminent financing problem for the Medicare program which the National Commission did not address at all. Under current law the Medicare financing deficits take on much greater proportions than those faced by the Social Security cash benefits programs.*

*While it is not clear how much of this situation the public understands in detail, it is clear that their confidence in Social Security has been badly shaken. While it is possible to separate short- and long-term considerations or even health and cash benefit program adjustments, it may be exceedingly dangerous to ignore the crisis of confidence that rejoins all the problems I have mentioned.*

*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 years 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. Many elderly beneficiaries fear that their monthly benefits will be cut off, and many young workers do not believe the program will even exist when they reach retirement age. Resolving the short-term financing problems, while not specifically addressing the long-term, may resolve the concerns of beneficiaries, but not those of young and middle-aged workers. Without confidence that the program is solvent, continued support may wither.

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.

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, there is broad agreement that today's workers should be assured that Social Security will persist. There even appears to be agreement that resolving the long-term deficit is necessary to reestablish program credibility. The disagreement comes on specific proposals to address the problem.

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. 1/

It is not clear what people perceive when they are confronted with questions relating to global policy options for "raising taxes" or "cutting benefits." It is clear that each of the long-term options that has been considered has taken on political opposition from various quarters. Those who advocate scheduled payroll tax increases or general revenue infusions to resolve the long-term problem appear to have insufficient support at this time to get passage of such measures. Those who advocate raising the retirement age, even indexing it for increases in life expectancy, also face apparently insurmountable opposition. Given the seeming stalemate encountered on the tax and retirement age fronts, other options may warrant considerations in light of recent polls showing that the majority of young workers still do not believe Social Security will survive until they retire.

One option considered by the National Commission that warrants further scrutiny and discussion would gradually adjust the benefit formula. This option would provide a slow and limited reduction in the percentage of preretirement income that Social Security replaces.

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

Social Security benefits are based on lifetime covered earnings. There are three benefit calculations factors (often called "bend points") in the benefit formula. Each year these factors increase by the rate of average wage growth in the economy. The practical effect of this procedure is to raise the purchasing power of Social Security benefits as wages grow over time. The adjustment to the benefit calculation procedure considered by the National Commission would index the benefit formula "bend points" by 75 percent of wage growth, instead of the full wage indexation that is now used. This would be continued until Social Security's replacement of preretirement earnings was reduced by roughly 10 percent. Under the assumptions used to evaluate the proposal this would take about 16 years. Yet over the period of implementation the purchasing power of average benefits would continue to grow steadily.

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. <sup>2/</sup> One of the options that we analyzed was this benefit formula modification evaluated by the National Commission. The results of our simulation analysis of the option are shown in figures 1 and 2. Figure 1 shows the growth in average family Social Security benefits under the current policy simulation in 1982 dollars as the solid upper line. The broken lower line in the figure shows future average family Social Security benefit levels under this option that would slow the growth of initial benefits levels through a modification of the benefit formula. The clear implication of figure 1 is that while future benefits would decline relative to benefits provided by current

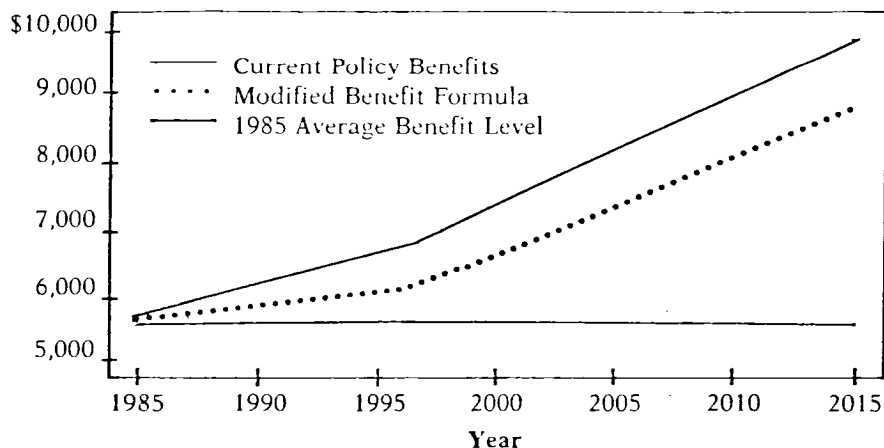
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<sup>2/</sup> For a complete description of this analysis see Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, D.C.: Employee Benefit Research Institute, 1982).



**FIGURE 1**  
**Future Average Family Social Security Benefits**  
**at Age 65**

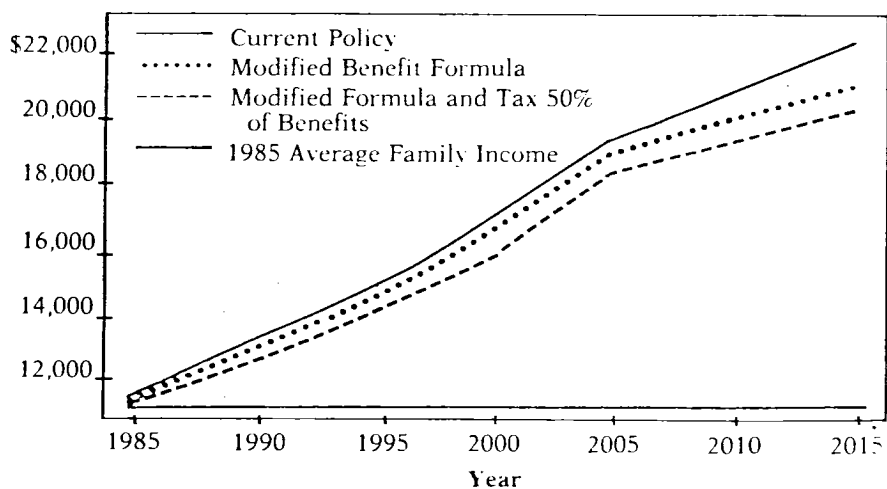
In 1982 Dollars



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.

the purchasing power of benefits would continue to increase throughout the implementation period.

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 National Commission estimated that if this benefit formula modification were implemented in 1984 the long-term savings for the OASDI program would be 1.08 percent of payroll. Yet it would only take \$3 billion out of the benefit pipeline between now and the end of the decade, or less than two-tenths of one percent of total projected benefit payments over the

period. But the proposal would not have to be implemented immediately. For example, if it were implemented in 1987 the projected savings would be 1.01 percent of payroll, still meeting the projected deficit. If it were implemented in 2000 the projected savings would be .80 percent of payroll.

This option may not be the first that many policymakers would naturally consider, but given the problems with the others it may be a middle ground where different perspectives can be blended. Some will perceive this as a benefit cut, but provisions could be made to assure that benefits do not decline in real terms during the implementation period. From another perspective this option can be perceived as a benefit cut only if the benefits under current policy to potential retirees decades hence are considered to be firmly committed -- on the way to the bank, so to speak. It may be tenuous to assume that the exact level of Social Security benefits to be paid ten, twenty, or thirty years in the future is broadly perceived as firmly committed now. More important is Social Security's commitment that future benefits will provide a reasonable base of support for the elderly's retirement income security. If a consensus cannot be attained on raising retirement ages or future tax rates, adjusting the benefit formula may be an option for achieving the long-term savings deemed necessary by the National Commission. As one of the possible options it should be publicly debated.

#### COMPARING VARIOUS LONG-TERM OPTIONS

Establishing various aspects of 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 simulation analysis at EBRI we compared the potential effects of five long-term Social Security adjustments 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 change in benefits was calculated. Table 1 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 benefit 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 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 1 suggest.

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

TABLE 1

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	100.0	
Price indexation of bend points	1.7	14.0	62.3	22.0	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	100.0	
Raising early and normal retirement ages three years	33.9	27.8	7.8	5.6	2.5	12.7	9.9	100.0	
Raising normal retirement age three years and adjust- ing actuarial factors	7.0	7.0	12.3	48.6	19.2	4.4	1.5	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.

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 assume 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.

#### SOCIAL SECURITY COVERAGE FOR FEDERAL WORKERS

The proposal by the National Commission that new federal workers hired after January 1, 1984 has created more acrimony and confusion than any other facet of the package. It is the only recommendation in the package being attacked in a coordinated media campaign. Federal workers do have some justification for concern, especially in light of other policy modifications being considered for their retirement program. Before reaching any conclusions as to the desirability of covering federal workers both the reasons for coverage and the arguments against need to be considered.

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 participation in Social Security.*

*Opponents of expanded Social Security coverage for federal workers, on the other hand, argue: (1) The Civil Service Retirement System (CSRS) covers federal workers and Social Security is unnecessary; (2) there is no modified federal pension to coordinate with Social Security; (3) it would bankrupt the CSRS; and (4) it would raise the cost of federal retirement for U.S. taxpayers.*

#### *Arguments for Coverage*

*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. 3/

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.

The reason that these bonuses take on the magnitude that they do is because of high turnover among newly hired workers in positions not covered by Social Security and high rates of Social Security reciprocity among CSRS annuitants. For the worker who spends up to five years in noncovered employment and then returns to a covered job, lifetime contributions can be reduced by 10 to 15 percent while benefits at retirement would only be reduced by 2 to 5 percent. Of newly hired federal workers 37 percent leave federal employment within five years and 49 percent leave in less than 10. Among CSRS annuitants over age 62 in 1979, 73 percent were getting a Social Security benefit and another 3 percent were eligible but had not yet claimed them. 4/

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

4/ Robert Dalrymple, Susan Grad and Duke Wilson, "Federal Civil Service Annuitants and Social Security," Research and Statistics Note (Washington, D.C.: Social Security Administration, December 1982), pp. 1-2.

Arguments Against Covering Federal Workers

Civil Service Retirement System (CSRS) covers federal workers and Social Security is unnecessary -- As with many policy issues the perception of this proposal's value varies from person-to-person. For the individual who ultimately receives a CSRS pension after a relatively full career of federal employment there is little need for added retirement income supplementation. For the person who falls off the merry-go-round before grasping the brass ring, however, CSRS has some gaping holes. In the discussion of arguments for coverage it was suggested that spouse and survivor protections offered by Social Security would enhance the protection afforded federal workers and their dependents. As an example of this, a recent article by Judy Mann in The Washington Post 5/ tells of two examples of divorced women whose husbands were federal employees. Shortly after their divorces their former husbands died. In one case the woman and her disabled son have to depend on SSI and food stamps for a meager living. Even after 36 years of marriage she had no pension claim. In the other case the mother of three children and homemaker had to go to find her own provisions despite 14 years of marriage. These were not problems of husbands having selected not to have survivor protection -- they were clear cases where Social Security coverage of federal workers would have benefitted survivors where CSRS did not.

It is little remembered that the Congress has already vigorously debated whether the prior existence of a pension plan should exempt and employer and his or her workers from participation in Social Security. The most heated issue in the development of the Title II provisions (old age

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5/ Judy Mann, "Survivors," The Washington Post, (Friday, February 11, 1983) p. C1.

insurance) of the original Social Security Act in 1935 was raised in the Senate Finance Committee. The issue was couched in the Clark amendment which would have exempted employers with pension programs from participation in the old age insurance program. In committee, this amendment was defeated on a tie vote. On May 20, 1935 the Senate Finance Committee filed a report in favor of the Social Security Act.

Debate on the bill in the Senate began on June 14. When the Clark amendment was reintroduced on the Senate floor, it became the subject of extended acrimonious debate. On June 19 the amendment was finally adopted by a vote of 51 to 32 and the Senate then approved the Social Security Act 77 to 6.

The Conference Committee did not begin deliberations until the end of June. All differences in the two legislative versions, with the exception of the Clark amendment, were reconciled by July 16. The conferees reported back to their respective bodies recommending adoption of agreed-upon facets of the bill and seeking further instruction on the Clark amendment. On July 17, both the Senate and the House accepted this conference report but the chambers instructed their respective conferees to hold firm to their different positions on the Clark amendment.

The Conference Committee set about having the amendment redrafted. After several weeks, the legislative drafters indicated to the committee that their work would extend beyond the end of the legislative session. The conferees then recommended that the Social Security Act be adopted without the Clark amendment, with the understanding that a joint committee be formed to develop such legislation for the next session of Congress. Such legislation was never put forward.

There is no modified federal pension to coordinate with Social

Security -- This is one of the strongest concerns that has been voiced in opposition to covering new federal workers under Social Security. To some extent this issue is jurisdictional and cannot be resolved without Congressional reorganization. Neither of the Committees with jurisdiction over Social Security in either the House or the Senate have jurisdiction over federal retirement. Legislation originating from the Committees with Social Security jurisdiction cannot include provisions for the supplemental federal retirement system. Conceivably the respective Committees with jurisdiction over federal pensions could offer legislation that would move in tandem with the Social Security bill. That does not appear likely at this time.

Outside of the legislative process there has been a great deal of developmental work done on various supplemental pension models that could be used to coordinate the federal retirement program with Social Security coverage. The Congressionally mandated study of universal coverage ordered by the 1977 Social Security Amendments provided detailed specification of four approaches to coordinate the federal pension program with Social Security coverage. <sup>6/</sup> The OPM actuaries and other pension specialists in OPM worked with the universal coverage study group in developing those models. The study group's models and analysis were reviewed in detail by the Office of Management and Budget, Department of the Treasury, the Department of Labor, and the Department of Health and Human Services, including the Social Security Administration.

While the ultimate level of benefits that could be provided by any one

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<sup>6/</sup> See Chapter 5 of the final report of the Universal Social Security Coverage Study Group, The Desirability and Feasibility of Social Security Coverage for Employees of Federal, State and Local Government and Private, Nonprofit Organizations (Washington, D.C., 1980).



of these models would be determined by the Congress, the coverage study group designed plans that in combination with Social Security would provide the same level of average benefits as the current CSRS. The study group focused on defined benefit plan designs in an effort to meet the benefit targets that were specified by the Secretary of the Department of Health, Education and Welfare. Their designs called for a supplemental thrift plan to encourage individual savings in addition to basic pension accruals.

Subsequent to the report of the coverage study group the Congressional Research Service has done additional analysis and design work in this area. The result of their work is incorporated in a bill developed by Senator Ted Stevens and introduced by him during 1982 as S2905. Senator Stevens' bill would provide for Social Security coverage of new workers hired by the federal government. It would also establish a new defined contribution pension program for federal workers. The combined programs would compare favorably with the retirement programs of other large employers in this country.

While there may be some legislative problems with moving a federal pension plan in tandem with Social Security, the practical issues in plan design have been researched thoroughly. From a purely mechanical perspective there is no reason that a supplemental federal pension plan to coordinate with Social Security coverage could not be designed and put in place well before January 1, 1984.

Social Security coverage of federal workers would bankrupt CSRS --

This argument is actually a multi-faceted set of analyses dealing with various aspects of past and current funding of CSRS. For example, some contend that without new contributions the 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. In fact 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 the fashion that many federal workers believe it does, (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. For example, James Pierce in recent testimony before the House Ways and Means Social Security Subcommittee argued 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. It is possible to go back and estimate what would have happened to the CSRS trust fund had the government exactly matched employee contributions in each year over the program's sixty-two year history. For example, the government made no contributions between 1921 and 1928. Had it matched employee contributions the additional accumulated contributions plus interest would have been \$164 million in the trust fund at the end of 1928. The government contribution continued to fall short of matching employee contributions through 1935. By then an added \$278 million would have been in the trust fund had the government matched contributions each year and paid the additional interest on them. For the next*

seven years government contributions exceeded employee contributions, catching up on previous underfunding. At the end of 1941 the added trust fund balance would have been \$131 million had contributions always been made on a matching basis. The government contribution rate continued to grow during World War II although a burgeoning workforce propelled employee contribution levels far beyond the employer rate. After the war there were massive withdrawals of employee contributions as war-time personnel went back to regular employment. Thus, while the government did not match employee contributions during the war, the latter did not represent actual increases in long-term liabilities. By 1949 the government, on a matching basis, was behind on contributions and additional interest to the tune of \$722 million. There were only two years during the 1950s when government contributions were substantially reduced, although the government contributed less in every year than the employees. By 1959 the government was \$2.7 billion behind (including interest) the employee contribution level. Beyond 1960 government contributions have exceeded employee contributions. However, because of additional interest the trust fund would have earned if contributions had always been matched the government continued to lose ground relative to the employees through the decade. By 1969, the matching shortfall reached \$3.5 billion.

If that \$3.5 billion were accumulated with interest to the present it would add about \$8 billion to the trust fund. However, since the passage of Public Law 91-93 the federal government has escalated its funding appropriations. By early 1973 it had paid off all prior contribution shortfalls plus interest. Since 1973 it is the employees who are behind on a matching contribution basis. By the end of fiscal 1981 their contribution shortfall plus interest was \$79.9 billion. Had the system always been run on a

*matching contribution basis, according to my calculations, the fund would have been totally depleted some time during 1982. To have continued the program on a current cost matching basis, benefits would have had to have been cut 55 to 60 percent at that time.*

*The total unfunded liabilities of the CSRS at the end of 1955 were approximately \$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 (23.9 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. The only reason that CSRS is solvent today is because the taxpayers have contributed more than \$120 billion to the system since 1970 while employees have contributed less than \$40 billion. It is clear the current CSRS is largely dependent on taxpayer support to meet current benefit payments; it continues to accumulate added liabilities for future generations of taxpayers as well.*

*In order for current obligations to be met in the future, whether new workers are covered by Social Security or not, the taxpayers will bear the largest share of the liabilities. One fundamental question that the Congress must address is whether covering new federal workers will raise the cost of federal retirement for U.S. taxpayers now or in the future. This is related to the last contention of those opposed to covering federal workers.*

*Effect on the cost of federal retirement -- Opponents of expanded Social Security coverage argue 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: 7/

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

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:

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7/ 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. 8/

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 assumed 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 2 shows the projected

8/ 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 2

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.

Another 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.

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 apply the FICA tax to 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 for the distribution of ultimate benefits such a policy may deserve additional scrutiny.