CHAPTER 1

OVERVIEW[A]

In December 1977, the Congress created a bipartisan, nine-member National Commission on Social Security to conduct a complete "study, review, and investigation" of all aspects of Social Security and related programs, and to develop a policy blueprint for the kind of system that would best serve the Nation in the future. In the words of the initial proponent of the legislation creating the Commission, it was to undertake a "fundamental, long-term, comprehensive consideration for change in the entire Social Security system."[1] The Commission was directed to report its conclusions to the President and the Congress two years after its work had begun. It was the first time that an independent body of private citizens, reporting directly to both the President and Congress, had been assigned such a task.

In accordance with its Congressional directive, the Commission determined to consider three fundamental questions:

1/ Remarks of Congressman Elliott Levitas, Congressional Record, 95th Congress, 1 st Session, October 27, 1977, p. 35396.

A/This brief chapter represents a consensus of views and recommendations. Dissenting statements and supplementary views of individual Commission members will be found in footnotes and statements in other parts of the report.

(1) Is Social Security and its companion programs, including Medicare and Supplemental Security Income,[2] the best way to provide income maintenance and health care to retired and disabled workers and their families?

(2) If not, what program or combination of programs offers a better way?

(3) If Social Security is the best available structure, what should be done to improve it and to make it financially sound?

To develop the findings and recommendations in this report the Commission met 25 times during the two-year life allowed it by law. It also held eight public hearings, each in a different geographical region of the country, at which 442 witnesses from 35 States offered their views. Commission members and staff visited Social Security offices around the country and talked with employees about program and administration problems. A two-day seminar was held at which academic and other authorities discussed the more significant issues

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[2] Throughout this report, the term "Social Security" refers to the Old-Age, Survivors, and Disability Insurance program (OASDI), funded through the payroll tax and administered by the Social Security Administration. Medicare is made up of two parts: Hospital Insurance (HI) and Supplementary Medical Insurance (SMI). HI is financed through the payroll tax and SMI is partially financed by enrollee premiums. The Supplemental Security Income (SSI) program is a federally-financed program of income assistance for needy aged, blind, and disabled people. The Medicare and SSI programs will be referred to, and treated, separately from the Social Security programs.

with the Commission and each other. The Commission studied the income support systems of foreign countries, made use of actuarial and econometric models and forecasts, and sponsored a scientific survey of public attitudes toward Social Security, which conducted personal interviews with a randomly selected sample of 1,549 respondents, designed to produce an accurate cross-section of the population of the United States.

The Commission made use of the valuable work of the 1979 Advisory Council on Social Security, the Universal Social Security Coverage Study Group created by the Secretary of Health, Education, and Welfare in 1978, HEW's 1979 Report "Social Security and the Changing Roles of Men and Women," and the President's Commission on Pension Policy, all of which were making studies and recommendations on a portion of the issues with which the Commission was concerned. It also solicited information and views from the Social Security Administration, the Health Care Financing Administration, 'the Bureau of Labor Statistics, and the General Accounting Office. All recommendations involving changes in program costs were reviewed in light of cost estimates prepared by the Office of the Actuary of the Social Security Administration and the actuaries of the Health Care Financing Administration.

Basic Conclusions

Based on its study, the Commission concludes that the Social Security system is sound in principle and, .of all alternatives, is the best structure of income support for the United States. The major alternatives to Social Security, examined in Chapter 3, are either too costly or offer insufficient assurance that income will be there when workers need it. Others are too limited in coverage or in benefits. All would cause serious problems in the course of making the transition from the present system.

Of all sources of retirement, disability, or survivorship income, Social Security has the best potential for stable real income, especially in times of economic adversity. Social Security provides a combination of features that, as a package, are not matched by private pensions or annuity plans: early vesting, automatic indexing to inflation, portability of earnings credits from job to job, benefits to family members, and exemption from taxes.

From its beginning, Social Security has been an integral part of an American plan under which government and the private sector cooperate to replace lost income. Since the 1930's, Social Security, private pension plans, and personal savings have, in concert, achieved an ever-increasing high level of security for the citizenry, while preserving its incentive for a productive life.

The existing Social Security benefit formula is generally satisfactory for middle and high income workers. When combined with the increase in the special minimum benefit[3/] and improvements in Supplemental Security Income (SSI), the current formula would also yield a basic floor of protection for those at the lower end of the economic scale.

[3/] The special minimum is a benefit based on the number of years a person has worked under Social Security rather than on his or her average earnings. This benefit is designed to help those who have worked for long periods at low wages and is paid only if it is higher than the worker's benefit based on the regular Social Security benefit formula.

Social Security is currently the largest domestic program of government, dispensing almost $11 billion in benefit payments each month to 36 million Americans. Controversial at its inception because of its compulsory features, it is now considered one of the most successful social programs of government. It provides an efficient and dignified way for the people of the United States to honor the responsibility all civilized people have to take care of the elderly and handicapped among them. The fact that workers must pay taxes into Social Security to be eligible for its benefits endows it with a character in keeping with the American tradition of providing for one's future.

Over the past few years, however, problems have arisen with Social Security that have generated widespread and increasing concern. As benefits have increased and the system has "matured"--i.e. the first age group of workers completed a full career in employment covered by the program--the fund built up over earlier years has diminished. Current cash benefits are funded almost entirely from current payroll taxes. A combination of inflation and unemployment has forced a drawing down of the Social Security trust funds, to levels very close to the margin of safety. [4/] So essential has the arrival of the Social Security check become in so many American homes, that for the system to run dry, even for a month, would produce panic as well as hardship. Yet several times during the 1970s, predictions were made that unless Congress took action,

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[4/] See discussion in Chapter 4, p. 56.

the trust funds would run out. The most recent available official estimate predicts this could occur for the OASI Trust Fund--the fund from which retirement benefits are paid--at some point during 1982.[5/]

The fiscal soundness of Social Security is intimately connected to the health of the American economy.[6/] Some economists have theorized that the very economic security the program offers discourages people from saving for their old age and is thus a major cause of the low rate of savings and capital investment the Nation has experienced in recent years. There are different points of view on this matter. The Commission's studies indicate that any such effect is small.[7/] The most recent study on this question concludes:

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z/Committee on Ways and Means, Subcommittee on Social Security, Social Security and Economic Cycles, WMCP: 96-75, 96th Congress, 2nd Session, November 12, 1980. (Cost estimates developed by the Office of the Actuary, Social Security Administration).

6/The Commission's studies do not indicate that Social Security contributes in. any significant way to America's current economic ills. A study done for the Commission on ways of financing Social Security found that an increase in the payroll tax used to pay for Social Security would have a slight effect on inflation and that the use of general revenues to pay for part of the program would have a smaller effect, and perhaps none at all. Baily, Martin Neil, Inflation and Social Security Financing,, a paper prepared for the National Commission on Social Security, June 1980.

7/Diamond, Peter and J. Hausman, Individual Savings Behavior, a paper prepared for the National Commission on Social Security, May 1980; and Fischer, Stanley, Savings, Capital Formation and Social Security, a paper prepared for the National Commission on Social Security, March 1980.

> .evidence does not support the hypothesis that the introduction of Social Security has substantially reduced personal savings in the United States.[8]

The financial difficulties the system faces arise from economic conditions outside its control. The problems of the economy are deep-seated and serious. They include a rate of inflation that has doubled the cost of living in eight years, an inability to reduce unemployment, and a rate of productivity increase that has averaged only 2.2 percent annually[9] in the last 10 years, well below that of most other industrial nations. Unemployment reduces the flow of taxes into the Social Security trust funds. Inflation that is not offset by increased wages eats into the trust funds still further because benefit payments automatically increase with rising prices. Impaired productivity aggravates the effects of both inflation and unemployment.

Unless the country can alleviate these economic problems, the Social Security program will eventually require taxes above the level which the public would support. At that point there will be no way, short of major reductions in benefits, for the system to pay its way. The Commission believes that the Nation's economy must achieve higher productivity, in order that a sound and comprehensive system of taxes and benefits can be maintained.

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[8] Leimer, Dean R. and Selig D. Lesnoy, Social Security and Private Savings: A Reexamination of the Time Series Evidence Using Alternative Social Security Wealth Variables, Office of Research and Statistics, Social Security Administration, November 1980, p. 30-31.

[9] International Comparisons of Manufacturing Productivity and Labor Costs, Preliminary Measures for 1979, Bureau of Labor Statistics, U.S. Department of Labor, May 22, 1980. The 2.2 percent productivity rate is the output per hour in manufacturing, averaged over the period 1970-79. Hart Research Associates, Inc., 1979, pp. 32-33.

The widespread attention given to these problems and predictions seems to have led a large percentage of Americans to have little confidence that there will be sufficient funds to pay their Social Security benefits when they qualify for them,[10/] despite the fact that this has never happened in the 45-year history of the program. This doubt is especially pervasive among younger workers, whose willingness to pay higher taxes than today's is essential to the solvency of the system. The attitude they take toward Social Security is especially important because the decisions they and their elected representatives make will determine the protection they will have when they retire.

At the other end of the age spectrum, many elderly citizens feel that their Social Security benefits, even when combined with their income from other sources, are inadequate to meet their basic financial- needs and obligations.[11/] For many, Social Security is their only significant source of retirement income. Others, who defer retirement beyond 65, feel their added work effort is not sufficiently rewarded because of the earnings test in the Social Security program.

In addition, changes in the economic and social roles of many American women have called into question the adequacy and equity of a structure of benefits developed at a time when the overwhelming majority of married women were homemakers., and female economic dependence was the rule rather than the exception. And while the public continues to give the Social Security Administration a high rating for efficiency,

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

[11/] Ibid., p. 23.

service, and courtesy compared with other government agencies,[12] the very size and scope of the program, as well as the new kinds of programs with more complicated eligibility standards, have put a strain on its staff. Its systems operations must be modernized in order to ensure timely and accurate payment of benefits in the future. [B]

The Major Recommendations

The Commission is making recommendations designed to help the Social Security system adapt to changing economic and social conditions.

Major changes in financing and a gradual approach toward a later retirement age will be necessary if the public's confidence in Social Security's ability to redeem its pledges is to be restored. The increased lifespan and better health of the American people justify raising the age of eligibility for full retirement benefits from age 65 to 68, beginning in the year 2001.

As the taxes necessary to support the program increase, a limit should be placed on Social Security's exclusive reliance on payroll tax financing. One-half of the cost of Hospital Insurance should be funded from general revenues. In addition, the Social Security trust funds should be partially funded from general revenues if and when payroll tax rates for Social Security and Hospital Insurance combined exceed 18 percent (9 percent on employers and 9 percent on employees).

12/ Ibid., Tables 81-84.

B/ For clarification of a number of common misunderstandings about Social Security, see Appendix B by Mr. Cohen and Mr. Myers.

Full wage indexing of yearly earnings should continue in computing the initial benefit level, to assure that initial benefits will reflect not only changes in the cost of living, but also increases in productivity that have occurred during a person's work-life.[13] When increases in the wages of covered workers in the economy fall behind increases in consumer prices, the automatic 100 percent indexing of post-retirement benefits to the Consumer Price Index should be reduced temporarily. The full amount of the reduction should be restored as soon as this wage/price difference reverses.

Several improvements should be made in Disability Insurance, Medicare, Medicaid, and Supplemental Security Income benefits. The Commission believes that all of these programs would be better managed by a Social Security Board, as originally conceived, as an independent agency of government, with trust-fund accounts that are kept separate from the Federal budget. In this way, benefits on which so many citizens depend for their day-to-day existence will not be subject to arbitrary cuts for budget-balancing purposes, and the difficult problems of financing the program can be worked out with fewer political constraints.

The Commission is making a total of 88 recommendations. The recommendations it is making for Social Security will restore the program's financial soundness, cement the public confidence on which it rests, and result in improvements in the program. In addition, the Commission is

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[13] For a description of how past wages are indexed to calculate a beneficiary's initial benefit, see Chapter 7, p. 56.

making recommendations for changes in the Medicaid and Supplemental Security Income programs. While these changes are also needed now, the question of what priority they deserve relative to other necessary programs of government must be decided by the President and the Congress.

The Limits of Predictability

Planning for Social Security would be much easier if the future were clearer. The Commission tried to determine the future costs of both the present program and the program improvements it wished to recommend, in order to estimate what levels of taxation will be needed. No such predictions can be assayed without first making certain assumptions about birth rates, mortality rates, and future trends in the economy--in general, the same type of assumptions the private insurance industry must make. In doing so, the members of the Commission recognized the inherent limitations of both actuarial assumptions and economic forecasting.

A central question involved in the long-run financing of Social Security is whether the ratio of active workers to beneficiaries will decline, as is now predicted, requiring substantially higher taxes even to maintain benefits at present levels. No one can predict with confidence whether the birth rate, which dropped for almost 20 years after the widespread availability of reliable contraception until leveling off recently, will stabilize, decline further, or resume an upward course. Even the medical profession cannot be certain of the future trend in life expectancy, even though it has been rising throughout this century. Nor can anyone foresee the course of technology and public policy well enough to tell what the long-term average rate of unemployment will be.

Short-term financing of Social Security is especially sensitive to changes in the economy. Under current "intermediate" assumptions,[14] each one percent increase in unemployment reduces income to the Social Security and Hospital Insurance Trust Funds by about $2 billion per year. Each one percent increase in the Consumer Price Index produces an automatic Social Security benefit increase of $1.4 billion per year. Yet the most sophisticated econometric models have failed to forecast these conditions with precision. Most do not attempt to project more than five to ten years into the future. It is important to recognize that all estimates for the future are based on assumptions about economic and demographic trends that need to be reviewed and updated as conditions change.

Equality of Sacrifice

The Commission considered the argument that the financial stability of the program, both present and future, requires reducing benefits from current levels or eliminating certain types of benefits. Other groups in the Nation, it was argued, are making economic sacrifices, yet Social Security benefits rise with the cost of living and the dollar amounts are never reduced.

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[14] Social Security cost estimates are calculated three ways, according to three separate sets of economic and demographic assumptions: optimistic, pessimistic and intermediate. Policymakers usually select the intermediate set of assumptions for costing purposes.

The Commission does not believe that Social Security beneficiaries should be exempt from all sacrifice when those whose taxes support them are making some. Its recommendation on the indexing of benefits after retirement reflects this. But they do deserve significant extra protection against economic adversity. They are less able than any other group in society to find alternative methods to preserve their buying power. More than any other group, they depend upon an updated program of income maintenance, of which Social Security is the most important component.

The Broader Needs

All the major issues of Social Security deal with money: benefits, taxes, trust funds, indexing, and medical payments. The Commission is impelled to note that while these matters are of utmost importance, the condition of the elderly, disabled, and survivors in America today is more than a matter of income. The Nation's posture toward them must encompass more than what can be measured by money.

The most generous Social Security program cannot give an elderly citizen a sense of self-respect or persuade an employer to hire a handicapped worker. It cannot substitute for a caring family or the respect of neighbors or for a loved one who is lost. What the Nation does with Social Security can offer proof against want and provide hope for the future, but the qualities needed to produce respect for the elderly and disabled, understanding of the enormous amount they can still contribute despite their limitations, and a desire to make them part of family and community cannot be legislated. For those, each of us must look into our own soul. Sooner or later, all of us will have to face the same adversities these Americans face now. For that, and many other reasons, the search should begin today.

Note to readers: Because Social Security and its related programs affect so many Americans and account for such a large portion of the Federal budget, the National Commission believes there should be greater public understanding of how the system works, in order to encourage broader and more informed discussion of future policies.

The Commission is aware that the public has been at a-disadvantage in this regard because most discussions of Social Security policy use terms too technical to understand. In this report, each term will be defined, either when first used or in the glossary appearing in Chapter 19.

SUPPLEMENTARY STATEMENT ON CHAPTER 1 - OVERVIEW

By Mr. Laxson, Mr. MacNaughton, Mr. Myers, and Mr. Rodgers

The purpose of this statement is not to take exception to the contents of Chapter 1. Rather, it is to place additional emphasis on certain aspects of the Commission's "overview."

The real key to the future viability of the Social Security program is a healthy economy under which there is a balance between productivity and benefits. In order to maintain the current level of benefits or to improve upon those benefits, it is imperative that the productivity of the country keep pace with its social desires. In the long run, it can't do what it can't pay for. We believe that, before anything else, the Nation should address itself to this problem.

The Social Security system is a transfer program. Income is transferred from those presently working to those who were once workers, and to the dependents or survivors of former workers. There is no significant delay in the transfer process -- the income withheld each payday is used almost immediately to pay benefits.

The intergenerational transfer nature of the Social Security system is important for at least two reasons:

(1) It is a human frailty to put high priority on immediate satisfactions and rewards, particularly where the costs are deferred for many years. When you add the political appeal of expanding

immediate benefits given the ability to defer additional taxes, the desired level of fiscal discipline tends to be weakened. The problem compounds as the proportion of retirees in our society increases; and

(2) The complexities of our monetary system tend to disguise the fact that expanding dollar benefits doesn't necessarily assure greater economic security for our citizens. While Social Security taxes and benefit payments are expressed in monetary terms, the scheme really amounts to a transfer of goods and services from the productive sector of the economy to the dependent sector. It follows that should the Nation make unsound decisions with respect to either payroll taxes or benefits, it could seriously impair the future effectiveness of the economic system, and in turn jeopardize the real economic security of both present and future generations of benefit recipients which strikes to the core of the Nation's well-being.

These are not concerns that anyone would knowingly treat lightly. But the Nation is tempted to follow the advice of pressure groups which often have a limited understanding of the long-term consequences of their recommendations.

The ratio of workers to benefit recipients has steadily declined over the years. It was 14 to 1 in 1950; 5 to 1 in 1960, and is currently about 3 to 1. A further decline to 2 to 1 is likely to occur over the next 50 years. Conservative projections suggest that Social Security and Medicare will absorb more than 25% of ail wages by the middle of the next century. Of course, a thoughtful society should do all that it can to secure its citizens against lost income and adversity. But, its efforts should be limited by the necessity of preventing a generational conflict. Social Security exists because of a consensus between generations. Without a consensus, the idea of public security for the aging must suffer.

To compound the problem, the increase in American productivity has been declining for some time. If this is to be a long-term trend, it presents serious problems for the Social Security program. A persistent decrease in productivity would result in a reduction in the standard of living of the work force. (Perhaps this is already the case.) If, at the same time, we maintain or increase the standard of living for non-workers, it seems clear that at least two things would likely result: (1) more inflation, and (2) conflict between workers and non-workers.

Lastly, from its original role of providing a basic floor of protection to be supplemented by employer, union, and individual plans, Social Security has assumed an increasingly dominant role in income maintenance programming. There is more involved here than the philosophical public versus private debate, even though that discussion is essential. An important virtue of private programs is that pre-funding of benefits creates capital. As private plans and savings accrue obligations to future retirees, equivalent assets are generated to be invested in job creation and productivity improvement that will help provide the goods and services for those future retirees. The trend away from private plans, which create capital, to pay-as-you-go public financing, as in Social Security, which does not create capital, reduces the funds available to fuel the economic system in the future.

As they consider the recommendations in this report, we urge the authorities to give serious consideration to the caveats contained in this supplement.

Supplementary Statement on Chapter 1 -- Overview

By Mr. Cohen, Ms. Duskin and Ms. Miller

Reference is made in the introductory chapter to the relationship between productivity and a "sound and comprehensive system of taxes and benefits.. . . " We concur with the view that it is easier to meet the demands of a society when the resources at its disposal are growing, particularly if tey are growing rapidly. But this does not necessarily mean that the obligations of a society cannot be met if this is not happening.

First, there is an important difference between a decline in the rate of growth of productivity and a decline in productivity. The former refers to a slowdown in the rate of growth in output per hour of work; the latter and more serious case concerns an actual decline in output per hour of work. In general, what we have experienced is a decline in the rate of growth of productivity.

This means that we have had some growth in the goods and services produced in the economy in most years in the last decade, but not as much as we have become accustomed to expect.

How serious is this change in our productivity? The answer depends in part on the starting point. For example, if we were a “poor” nation, producing barely enough for each person to survive, then a decline in productivity would indeed be serious. In our case, while we may not appreciate other countries catching up and even surpassing us in per capita output, we are hardly injeopardy of mass starvation or any event nearly as dire. We would have a critical problem only if we thought that we could never do any better than we are doing now. And nobody is saying that!

The first conclusion, then, is that we are not at the brink of disaster. In fact, some economists say that we have had some choices in the matter and that the primary “disaster” was our failure to operate at a high level of productivity because of inappropriate fiscal and monetary policy!

The second important point is that the economy doesn’t have to grow at the same rates it did in the past in order to support the Social Security system as we know it today. Any positive real rate of growth could leave the system in reasonably good shape.

The next important point is that if we had no real growth in productivity for a long time, we could still support the Social Security system if we had to do so. Even with fixed resources, we still have the option of deciding how those resources will be divided among competing uses. In the case of a family that expects an increase in yearly income that doesn't materialize, the family may postpone some anticipated expenditures, but it continues to spend resources on what it considers essential. Although the family may be disappointed, it's no worse off. The country, too, may have some disappointments, but it won't necessarily be worse off. Neither will Social Security.

Hopefully, none of this discussion should make the reader forget that increasing our rate of productivity remains very important.