SOCIAL SECURITY: WHAT CHANGES ARE NECESSARY?

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SOCIAL SECURITY: WHAT CHANGES ARE NECESSARY?

TUESDAY, DECEMBER 2, 1980

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, D.C.

The committee met, pursuant to notice, at 9:20 a.m., in room 6226, Dirksen Senate Office Building, Hon. Lawton Chiles, chairman, presiding.

Present: Senators Chiles, Pryor, and Burdick.

Also present: E. Bentley Lipscomb, staff director; John A. Edie, chief counsel; David A. Rust, minority staff director; Neal E. Cutler, professional staff member; Eileen M. Winkelman and Betty M. Stagg, minority professional staff members; Marjorie J. Finney, correspondent; Fred Becker, intern; and Eileen Bradner, clerical assistant.

OPENING STATEMENT BY SENATOR LAWTON CHILES, CHAIRMAN

Senator CHILES. Good morning, and welcome to the second hearing in our series, "Social Security: What Changes Are Necessary?"

The major thrust of this morning's testimony will be on indexing, or how do we keep social security benefits even with inflation.

The issue of indexing arises in two different ways: (1) Indexing to determine the initial benefit level, and (2) indexing to provide an annual cost-of-living adjustment to those already receiving benefits.

Let me state these two issues another way.

Several groups and economists are recommending a change in the manner of calculating initial benefits by changing from wage indexing to price indexing. Because historically prices have not risen as quickly as wages, a switch to price indexing would slow the growth of benefits and save the trust fund billions of dollars.

Similarly, several different recommendations have been made to alter how the annual cost-of-living increase is calculated for those now receiving social security. Criticism has been leveled at the present method of using the Consumer Price Index, or CPI. Options for change have included: (1) Changing the CPI to reflect inflation more accurately, (2) using a different formula altogether, (3) indexing by wages or prices, whichever is lower, and (4) limiting or capping the CPI at 67 or 85 percent.

There is great interest in both of these issues, and their effect on the budget and on the financial stability of the social security trust funds is potentially enormous.

Robert Myers, who is a member of the National Commission on Social Security and the former Chief Actuary at Social Security, will

get us started this morning by presenting his views on these important issues.

I am particularly concerned about inflation and the devastating effect it can have on the retired person. Just last month the Census Bureau reported some disturbing news. According to their recent analysis, for the first time since 1975 the number of older persons below the poverty line increased.

In addition, Data Resources, Inc., a noted economic research firm, recently completed a study that predicts that inflation in the 1980's will eat away half of the gains made by the elderly in the 1970's. If the Census Bureau is right, this erosion of income may have started already. I am pleased that Mr. Duffy from Data Resources is here today to discuss his report.

Finally, we will hear from Dr. Thomas Woodruff, the Executive Director of the President's Commission on Pension Policy. The Commission, just 2 weeks ago, released their second interim report which contains many important recommendations on changes to social security. We are looking forward to hearing an update on the Commission's progress.

In closing, let me say that at our hearing tomorrow afternoon we will hear testimony from six noted national organizations representing older persons. Their comments and reactions to the many issues raised at our hearings will be a significant addition to our understanding of what lies ahead.

Before we hear from our witnesses, I have been told that the Republican Members are involved in a caucus and will not be able to attend our hearing. Senator Pete V. Domenici, the ranking minority member of our committee, has submitted a statement for the record, and without objection, it will be entered into the record at this point.

[The statement of Senator Domenici follows:]

STATEMENT OF SENATOR PETE V. DOMENICI

On Friday, November 21, we heard Henry Aaron of the Brookings Institution and Robert Ball, National Academy of Sciences, state, with varying degrees of urgency, that the social security program has long- and short-term financing problems of a critical and serious nature. The most critical short-term concern is the need for additional funds in the OASDI trust funds by 1984. For the long run, continuing increases in benefits combined with a doubling of the eligible population could mean a severe shortage of funds between 2015 and 2040.

Having heard a broad overview of the problems in that opening hearing, today we turn our attention to some of the specific ideas which are being discussed as possible solutions.

The first is the method by which we adjust benefit levels to keep pace with inflation. Currently all social security benefits are increased each year by an amount equivalent to the annual increase in the Consumer Price Index. This year with inflation running at excessive levels, we added $14 billion to the cost of social security overnight with this cost-of-living adjustment. This has led many of us to ask not only whether we can afford this increase, but also, whether or not this measure is accurate and fair to recipients and wage earners who are paying social security taxes.

Another proposal which continues to receive much attention is wage versus price indexing, or the best method by which to update a workers past earnings when computing the initial benefit. Even though those alternatives were debated during consideration of the 1977 amendments, the need to strengthen the long term financial future of social security has rekindled the discussion of wage versus price indexing.

The entire procedure of indexing the benefits level is complex and any change of this magnitude demands our careful study. For example, some of the questions I have, and which may be addressed by our witnesses today include:

—If price indexing were substituted for wage indexing would retirees of the future have purchasing power which keeps up with inflation?

—What is the estimate of the actual difference in benefit amount for an "average wage" worker retiring in the future under each of these alternatives?

—To what extent would price indexing result in a drop in the social security replacement rate and to what extent is the remainder of the replacement picture filled in by other sources of retirement income?

—If we had recurrent periods in which prices rose faster than wages, would short-term financing be jeopardized by a price-indexing approach?

I am confident that the testimony of the witnesses today will be a great help to the members of the committee and our colleagues with whom we will share their findings and recommendations.

Senator CHILES. Please proceed, Mr. Myers.

STATEMENT OF ROBERT J. MYERS, SILVER SPRING, MD., MEMBER, NATIONAL COMMISSION ON SOCIAL SECURITY, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION (1947-70)

Mr. MYERS. I might say I am appearing here in my personal capacity, not on behalf of the National Commission on Social Security. I should add that in our final report which is due January 11, the Commission's recommendations, on these two topics which I am discussing, as it so happens, will be exactly what I will say here.

I should also point out that, before starting to discuss these two indexing procedures—namely, for people on the roles and in computing the initial benefits—I am a strong believer that people who have accrued rights—even though they may have come from procedures that were not desirable—should have them protected. In other words, I believe that any changes that are made should only be prospective and should not disturb what people have been led to believe that they have accumulated to date.

For example, you will recall that several years ago, the Carter administration proposed, among other things, to eliminate the $255 lump-sum death payment immediately. I think that, although this particular benefit is not too meaningful a one, yet it is something that people have counted on. Many retired people have it as part of their burial plans, and I think that it would be wrong to take it away. If that particular benefit were to be eliminated, it should be done only after due notice, a number of years hence, for people retiring after that time.

To turn back to indexing, I would first like to take up the matter of indexing benefits in current payment status; that is, for people who are currently receiving benefits. Under these circumstances, benefits are increased as of each June if the Consumer Price Index for the first quarter of the year has risen by at least 3 percent over that, for the same period of the previous year—or over that for the last preceding year when there was a benefit increase. In the past 2 years, these automatic increases have been quite large, 9.9 percent in 1979, and 14.3 percent in 1980. They have significantly exceeded the rises in general wages of covered workers, and this has caused financial problems of a cash-flow nature for the social security system.

Before proceeding further, it is important to point out that inflation by itself does not necessarily cause financing problems to social security. Rather, what is controlling, is the particular type of inflation. For example, even if prices are rising rapidly, the program would have no financing problems if covered earnings subject to tax were increasing at the same rate or much more rapidly. However, there are problems when prices are rising more rapidly than wages, as is unfortunately currently the case.

These results occur for several reasons. First, the total benefit outgo is directly affected by the changes in prices due to the automatic adjustment provisions, which are based on increases in the CPI. Second, the supporting tax revenues are directly affected by the changes in taxable earnings, both as such earnings increase directly and as the maximum taxable earnings base—$25,900 in 1980—is raised by the automatic adjustment provisions.

Recently, proposals have been made to hold down the automatic CPI adjustments of benefits made each June. One justification for doing this is that prices have risen more rapidly than wages, so that beneficiaries have been placed in a better position than active workers, which I think hardly seems logical. Another reason is that the CPI seems to overstate the extent of inflation, particularly because of its treatment of housing costs. Specifically, the computation of the CPI assumes that, for the small percentage of persons who buy a house each year, the entire price increase is properly to be counted. Actually, many purchases of homes are merely trades or small upgrading of living facilities, and so the entire price of the house should not be considered as a weighting element. Rather, what should be considered is only the increase in the cost of one house over the other. Accordingly, I believe that some revision downward in the CPI adjustment of benefits seems reasonable.

One type of proposal to reduce the CPI adjustments has been to use only a fraction of the CPI rise, such as 80 percent. I do not favor this approach, because it is so arbitrary and has no logical basis.

Others have proposed that the GNP deflator index or a modified CPI index involving rental equivalents—rather than new housing costs—should be used. I prefer staying with the widely recognized CPI, although it should possibly be adjusted for the housing element. However, if this is done, great care should be taken that the adjustment takes into account retroactive circumstances for several years—so as not to give unusually high increases that might occur by chance under the new basis, which would augment excessive increases in the past under the former basis.

Still others propose that a special CPI should be developed for the aged—or, I would say more properly, for social security beneficiaries, because not all of them are aged. My studies of such fragmentary data as are available on this matter indicate that this procedure would give about the same results as using the general CPI. Accordingly, there is no reason to change, but it should be noted that it is very important in this respect that what counts is not the height of the index, but rather the rate of change in the index from period to period.

The best solution in modifying the automatic adjustment provision for beneficiaries on the roll is to retain the present approach, except

in times of unusual economic conditions when wages rise less rapidly than prices over an extended period. Specifically, in considering the benefit increase for a particular year, the figure derived by comparing the CPI for the first quarter of the year with that for the first quarter of the previous year, should be reduced if wages rose less rapidly than the CPI in the current year and the immediately preceding year combined. There should, however, be a retroactive catchup period if reductions in the CPI increase were made under this approach, but later wages rose more rapidly than prices. This reverse differential would be recognized by providing a larger benefit increase than the CPI rise until all previous downward adjustments were made up.

In table 1 I have given an illustration of how this procedure operates. The effect of such a modification on the financial status of of the old-age, survivors, and disability insurance trust funds is shown in table 2.

TABLE 1.—ILLUSTRATION OF OPERATION OF MODIFICATION OF AUTOMATIC-ADJUSTMENT PROVISION FOR BENEFICIARIES ON ROLL

[In percent]

Year	Increase in CPI[1] (1)	Increase in wages[1] (2)	Real wage increase (3)	Current adjustment[2] (4)	Cumulative adjustment (5)	Benefit increase[3] (6)
1978	6.5	8.1	+1.6	(4)	(4)	(4)
1979	9.9	7.2	−2.7	−.6	−.6	9.3
1980	14.3	8.4	−5.9	−4.3	−4.9	10.0
1981	10.1	9.7	−.4	−3.2	−8.1	6.9
1982	9.8	9.8	------	−.2	−8.3	9.6
1983	8.2	8.6	+.4	+.2	−8.1	8.4
1984	7.3	8.0	+.7	+.6	−7.5	7.9
1985	6.4	7.5	+.9	+.8	−6.7	7.2

[1] Based on first-quarter data; 1978–80 are actual data, while later years are the assumptions in OMB's 1980 mid-session review.
[2] Average of col. (3) for present and preceding year.
[3] As long as col. (5) for previous years is negative, this is (a) col. (1), plus (b) col. (4) or, if smaller, col. (5) for previous year.
[4] Not applicable.

TABLE 2.—PROGRESS OF COMBINED OASDI TRUST FUNDS IF MODIFICATION OF AUTOMATIC-ADJUSTMENT PROVISION HAS BEEN OPERATIVE AFTER 1978

[Dollars in billions]

Calendar year	Income	Outgo	Excess of income over outgo	Fund at end of year	Fund ratio (percent)
1979	$105.9	$107.0	−$1.2	$30.6	30
1980	119.6	121.2	−1.6	29.0	25
1981	136.3	136.3	−.1	29.0	21
1982	154.8	151.9	+2.9	31.9	19
1983	172.5	170.1	+2.4	34.3	19
1984	191.8	189.0	+2.8	37.1	18
1985	222.5	208.6	+13.9	51.0	[1] 18

[1] The fund ratio at the beginning of 1986 is estimated to be 22 pct.

It is very significant to note that this one change, if in hindsight it had been introduced in the 1977 amendments, would have completely eliminated the financial crisis now facing the OASDI system in 1982–85. The trust fund balance always would have been substantially above

$25 billion and the yearend fund ratio—that is, the ratio of the fund on hand to the annual expenditures in the coming year—would never have fallen below 18 percent.

Next I would like to talk about the computation of the initial benefits; in other words, what is done about the past earnings record of people in computing their benefit. Under present law, the past earnings record is indexed by wages before it is used to determine the individual's average earnings over the prescribed period of years that is used in computing the average wage, which in turn is used to compute the benefits. For example, a person who earned $3,000 in 1951, and who attains age 62 next year, would be considered as having earnings of $12,303 in 1951. This is called the indexing of the earnings record and is done by considering the changes in wages over the period of years, so that the effect of inflation is offset.

Pension plans and public employee retirement systems, such as civil service retirement, solve this problem of inflation as it affects past earnings by using an average final salary basis, such as the highest 3 consecutive years—which generally tend to be the last 3 years. In social security, the same general results are obtained by indexing each year's earnings in the manner I described previously, so as to make those earnings comparable with recent earnings. This procedure is called wage indexing. Then, these indexed earnings over a long period of years can be averaged, so as to yield a meaningful average earnings to use in the benefit computation process.

Some people have suggested a different indexing procedure. What they propose is that the past earnings would be updated only by the increase in the CPI over the years involved, rather than the increase in wages. Because in the past—and quite likely in the future—prices will rise less rapidly than wages, the price indexing procedure will not bring previous earnings up to the level of recent earnings. For this reason, among others, I believe that this approach of price indexing is illogical and untenable and is really unacceptable for a satisfactory social insurance system. Also, under price indexing, the dollar bands in the benefit formula are adjusted by CPI changes, rather than by wage changes as under present law; this also will produce lower benefits over the long run.

Under present law, with its wage indexing procedure, a worker with average earnings throughout his or her working lifetime will receive a primary benefit at age 65 equal to about 40 percent of recent earnings. On top of this, there will be supplementary benefits for the wife and any children. This 40 percent will occur regardless of when age 65 is attained, whether in the near future or many years hence, and this is a great advantage of stability that is produced by wage indexing.

However, under price indexing, if wages rise more rapidly than the CPI, as we anticipate, the benefit payable will be a lower percentage for those who retire many years hence than for those retiring in the near future. Ultimately, the rate for the average earnings worker may become as low as 25 percent, rather than the 40 percent at present. The result, if no changes are made, would be to produce much lower benefits in the long run for workers at all earnings levels, and this is what creates the apparent magic of lowering the cost of the program which I believe would be done in a very unrealistic way.

I believe that the price indexing approach is undesirable for a number of reasons. First, it does not represent proper pension planning, because relative benefits will be lower for the longest term contributors, those who retire many years hence. Certainly, such an approach of declining relative benefits has never been considered suitable in private plans. The younger generation can logically argue that such a policy is a "ripoff" as compared with the current older generation; they would pay longer and at higher tax rates, and yet they would receive lower relative benefits. This just does not seem right to me.

Some proponents of the price-indexing approach argue that the Congress will, and should, change the situation in the future so that such declining relative benefits will never really occur. Of course, if this is done, the vaunted savings of the price-indexing approach over the wage-indexing approach will not occur either. It seems to me that it would be poor legislative development to institute a plan that is known to be defective and that is known to need change in the future. I think it would just deceive people into thinking that the cost of the program was being lowered, when in reality this would never eventuate. On the other hand, wage indexing of the earnings record, for benefit computation purposes, will produce stability of the benefit level. I think that this is an essential thing in a social insurance system—namely, have stability in the system, not only stability in financing, but also stability in the benefit structure.

The important thing in providing economic security is to relate the benefits payable to the recent standard of living just before retirement—that is, to wages. Then, people can, in advance, know just what to expect relatively from social security, and they can then plan adequately as to their future needs through the private sector—employer-sponsored pension plans and individual savings efforts.

Thank you, Mr. Chairman.

Senator CHILES. Thank you, Mr. Myers.

In your statement you indicate you feel it would be undesirable to switch from the wage indexing to the price indexing. Other witnesses share your view. However, one witness, an economist, Henry Aaron, supports price indexing. He testified that the change could ease the long-run deficit of the social security system. Do you believe that we have a long-term deficit problem, and if so, if we are not going to change the indexing, what steps should Congress take to address this problem, and do we need to take action on that right away?

Mr. MYERS. Yes, Mr. Chairman, I agree that there is a long-term financing problem under present law. Actually, as you may recall, in the 1977 amendments as they went through Congress, the Senate version of the bill did provide for sufficient financing so that there would have been no long-term deficit. Unfortunately, in my view, and with all due deference to my friends on the House Ways and Means Committee, in conference they prevailed and did not provide adequate long-term financing. What do we do about the situation we are in now?

My solution to this problem is really threefold. First, as I have recommended elsewhere, I believe that the minimum age for full benefits should be gradually increased in the future, beginning about

20 years hence, so that by the year 2012 it would reach age 68. I do not propose this solely for cost-savings purposes, but rather to keep the real value of the retirement age at about the same level.

Mortality is improving. It has improved in the past. One of the reasons for the estimated deficit is the assumption that mortality will improve. Therefore, as mortality improves, people should work longer. They will be in better health, and they can do this and still have the same length, or even a longer, retirement period than people retiring today. That change would completely solve about two-thirds of these long-term deficits.

Another change that I believe should be made is universal coverage—in other words, to cover all governmental and nonprofit organization employees who are not now in the system. This might be accomplished on the basis of just doing it for new entrants. Again, this is not done primarily for financing reasons. It is done for other reasons such as preventing windfall benefits. Nonetheless, it does produce a small, although quite significant, long-term savings to the system. Along with the change in the retirement age, the deficit would then be virtually eliminated.

The other thing that can be done to eliminate any remaining deficit is to have slightly higher tax rates in the program 30 years from now. I think that the level of the tax rates is not so high that a little higher rate could not well be borne by the populace, especially as the increase in the rate is gradually eased in, as has been done in the past, when the rate has gradually been increased a little bit at a time.

That is how I would solve the long-term financing problem, rather than doing it by price indexing, which I think is a snare and a delusion. It seems to reduce costs, and it does so by a benefit structure which I think Congress is almost bound and obliged to remedy as time goes by.

Senator Chiles. Well, in listening to your rationale for not wanting to, not feeling it would be fair to change from wage indexing to price indexing because the younger workers in the system would feel ripped off, aren't you going to have these same feelings as you raise the retirement age? Aren't the ones that are now in the system going to see what you are doing as you are raising that age so that they are paying for the people who are retiring at age 65 but they are not going to be able to retire until age 68?

Mr. Myers. I think that, on the surface, they might believe that, but with the discussion that has been going on and with the continuing education, people will gradually understand the logic and the need for such action. The person retiring at age 65 today will live an average of about 14 years. In the future, when today's young people reach age 68, they will have an average lifetime from age 68 on of 14 or more years. Thus, when you look at the situation as to the expectancy of retirement life, they are not being ripped off. They are having the same average length of benefits as people retiring at age 65 today.

Senator Chiles. In his testimony before us on November 21, former Commissioner Bob Ball indicated that he did not think that the long-term financing problem was that serious, at least not serious enough to warrant cutting back on the benefits at this time. He acknowledged that certain demographic trends could force a problem in the next century but he felt those trends could just as easily go in a

more positive direction and, in short, Mr. Ball felt that all we needed to do now was legislate a modest payroll tax increase to go into effect after the turn of the century, an increase that he said could be adjusted or amended as circumstances became more evident.

My question is this. Do you share Mr. Ball's lack of concern about the long term, and how far do you think we can go in raising the payroll taxes as a means to solving the financial problem?

Mr. MYERS. I do not agree entirely with Mr. Ball. I think that there is a very significant financial problem 25 to 30 years from now. The solution to it is in the manner that I indicated. It is desirable to take action now, or at least to talk about it now as is so widely being done, so that younger workers are aware of it. It would be most unfair to start raising the minimum retirement age abruptly, because people tend to think of retirement age as they reach it, and they make their plans accordingly.

If younger people—I am saying age 45 and under—realize that the retirement age is a flexible thing, and it depends on life expectancy, just as benefits are adjusted, as they should be, to keep their real value. Accordingly, the retirement age should be flexible and adjustable, too. As long as people know about this in advance, I think it can be done, and people will accept it when they understand the real situation and do not just base their retirement expectations on a fixed figure like 65, but rather base it on how long a retirement period they will have.

Senator CHILES. I am intrigued by your suggested approach to modifying the use of the CPI to keep benefits up with inflation. Your approach seems not only to have the chance of helping solve short-term financial pressures, but it also was designed in a way to emphasize the important equal treatment between retirees who get the benefits and the workers who are paying for them.

Obviously, to a Senator suggesting that the full CPI not increase, that it not be made available in every instance, is not going to be very popular, but I see several other advantages to your proposal. It seems to me that workers would not resent so much the fact that retirees are getting bigger raises than they are, and retirees would understand that their reduced cost-of-living adjustment would be made up later under better economic conditions. Have any other groups reviewed your proposal and given it any support?

Mr. MYERS. Mr. Chairman, as I mentioned, the National Commission has adopted this as a final recommendation. A substantial majority of the Commission agreed with this. Also, although we are very much interested in social security beneficiaries getting a fair deal in times of financial stress like the current situation, we believe that the covered workers who are paying for the program should not be worse treated. Some other people may have considered this approach, although I cannot say that for certain. There has been some discussion of this approach in the press, and there has been some agreement with it. However, it is a relatively new idea. Although the National Commission adopted this at a meeting open to the public, there was no publicity given to it at the time.

Senator CHILES. Well, thank you very much. I may have a couple of other questions for you afterwards.

Now I would like to hear from Mr. Duffy, of Data Resources, in connection with his report.
Mr. Duffy.

STATEMENT OF MARTIN E. DUFFY, VICE PRESIDENT OF CONSUMER ECONOMICS DIVISION, DATA RESOURCES, INC., LEXINGTON, MASS.

Mr. DUFFY. I guess my perspective does not differ too greatly in terms of the condition of the aged or the way in which they should be treated in the next decade than Bob Myers, but what I would like to do is set a different tone to this discussion and to really focus not so much on the system but on the results of the system and measure these results in terms of the households affected. I think right now there is the renewed theme of competing ideologies regarding the role of Government, its efficacy, and the role of the private sector. This is true not just in Washington but throughout the world. We are entering into an era now of slower growth which sharpens this dialog.

We have not adjusted as effectively to the higher energy prices of the seventies as we hoped we would. The OPEC cartel appears more powerful than ever and inflation more endemic. Labor supply is growing more slowly and overall economic growth is forecast to be less in the decade ahead. With slower growth, we are looking at a future now which is clouded by our apprehensions.

Within the context of higher cost of living and slower growth, what then happens to the elderly? Despite the problems in the seventies that constrained this economy, we have achieved much to their betterment while distributing the fruits of growth throughout all of our society. The size of government increased during this time as well, primarily through higher transfers. In the longer period, 1967 through 1979, personal transfer payments grew at a real annual rate averaging 8.7 percent. These transfers are now going to grow more slowly. We expect a real rate of growth in transfers of only 3.5 percent over the next 25 years.

When you look at transfers in 1980 as a percentage of the Federal budget, the cost to that budget was 42 percent. At a real growth rate of 3.5 percent, we forecast that transfers will occupy 51 percent of the budget in 2005. The question is can we afford this growing allocation of Federal resources to transfers? Can policies be changed now in any way to cause the future to be a little more sanguine both for younger Americans and older Americans? I think there are some answers there and I think the answers flow from the analysis. But, before proceeding, let me go through what has happened to the aged and where they appear to be going in the future.

The real income of the aged has advanced tremendously since 1970. We have seen a very comforting advance in real income, which, while not alleviating all incidence of poverty or near poverty among the aged, did substantially advance their status. If you look at the average money income of single elderly women, women aged 65 or more today, it is less than $130 a week. Now you can add in other in-kind-transfer programs which affect these elderly women and you can come up with a higher adjusted income number for them, but we're still left with a very low-income population group. We have not solved all problems, but we have made some major progress.

The elderly have gained significantly in the entire postwar period, but particularly in the last 13 years. Beginning in 1967, changes in social security raised the amount and percentage of income that was going to elderly households. Real and relative incomes were increased despite falling labor force participation, particularly by preelderly—aged 55 to 64—and elderly men.

Since 1967, the real income of the elderly advanced a real 2.4 percent a year. That increase more than compensated for the gains that were being made by younger Americans so that the relative income of the elderly advanced significantly. This gain is documented in my accompanying report. These advances in average money income per elderly households were made despite the fact that the number of aged were increasing at a rate twice as fast as the number of younger Americans.

Then if we go forward with this analysis, model that kind of process and add in how the U.S. economy both retrospectively and prospectively affects the aged, we forecast continuing growth in real income for the elderly. However, future growth will be smaller, averaging less than 1 percent a year versus the preceding 2.4 percent a year. Relative to younger Americans the period of catchup for the elderly is over and we expect a relative income decline for older Americans in the future. We also foresee an era when price increases in energy, food, and health, the core necessities for elderly Americans, are going to continue to gain faster than inflation in general. Food prices next year will rise, even by USDA estimates, anywhere from 12 to 15 percent. The forecast increase in food would exceed the rise of this year and be greater than any yearly advance in any year since 1974, the year we were affected so dramatically by the Russian grain purchases and by bad weather.

We look at a future period where food, energy, and health, the necessities that make up so much of the elderly's market basket, are going to be rising faster than inflation. Unlike the seventies, their incomes will be rising slower than younger Americans and at less than 1 percent a year.

Despite a continuing advance in income, we are looking at a future that is less auspicious for the aged. This forecast assumes social security and other Federal policies as they are. Any deliberation of social security will pare the present thin margin of growth and introduce a period of stagnation or perhaps even decline. Indexing procedures in social security that would take away the wage index or reduce it to 70 percent of the CPI would redistribute the burden of social security losses unevenly to the recipients. These effects should be modeled in the context of the future economy and the demographics of elderly segments.

So we are looking at a period where incomes for the aged are going to be moving ahead very slowly, particularly in relation to the immediate past. Without a major change in labor force behavior, that seems to be inevitable. The major swing variable in the forecast is the possibility, or the hope, that the near elderly and the elderly increase their work effort. Today only about 18 percent of men aged 65 and over are in the work force. Even in the cohort aged 55 through 64, only 74 percent of the men are in the work force. Over 90 percent of those men were working in 1950; now we see that less than 75 percent

are so engaged. On a simple comparative basis that translates into a rate of idle capacity of over 25 percent among these preelderly men. It is even higher for women.

Less than 20 percent of men and less than 10 percent of women are in the work force at age 65 or more. We have had this tremendous advance of better health, better nutrition, and declining mortality in the postwar era. Yet retirements are occurring earlier and earlier. The average man, aged 65 today, is going to live another 14 years, the average woman another 18 years. People are incredibly myopic about their retirement decision and the long period of retirement that follows. I think, too, that Federal policy is very myopic about this decision and the attendant imposition of long-run costs. The best salvation against inflation toward advancing the wherewithal of the aged is to change institutional policies, both industrial and Federal, to encourage a later retirement, to reduce the burden of retirees on the working population and, by that very fact, solve the problem in large measure of financing the future social security system.

The social security system itself is a masterpiece in terms of the way it has been positioned and administered. It has enhanced the rights and benefits of its constituents while preserving an enviable record of accord with those who are bearing the burden. But there is no free lunch and now we have to make some decisions about whether we preserve the system pretty much as it is or do some alterations. Whatever is done should recognize the logical and impelling differences between those who are already retired and those who have yet to make this choice. The incentive system should be tilted more and more toward keeping people in the work force while real benefits to the already retired are at least preserved.

There are two kinds of problems in administering social security: How do we keep more people working while in the twilight of their worklife and what do we do about income adequacy for those already retired.

The future U.S. labor force is forecast to grow in the eighties at a rate of about 1.5 percent a year. Its rate of growth declines further in the nineties and beyond the year 2000 due to demographic changes. You can compare the forecast 1.5 percent of the eighties with the 2.4 percent a year increase achieved in the seventies. We are going to see a tremendous decline in the number of new entrants in the labor force even with increasing participation by women.

From 1929 forward, except for occasional periods as World War II, we have been in an era of labor surplus. In 1935, social security was enacted for many reasons, among which were to get aged men out of the labor force, reduce unemployment, and to care for the needs of the aged. The eighties and the nineties, particularly for certain kinds of employment prospects in the eighties, offer a time, perhaps, when the aged and the near elderly can be called on to offer more work effort, to contribute to overall production and, in effect, guarantee a more prosperous retirement for themselves and for the already retired.

The cost of not pursuing these policies will exacerbate the potential deficit in social security. However, retirement behavior does not turn around quickly. If you looked at those persons, particularly men aged 55 through 64, and those aged 65 and above, you would expect, aside from the income gains, greater labor force affiliation because of mount-

ing uncertainties from inflation and because of the losses that have occurred to retirement savings and private pensions during this period of time. The answer is the opposite, labor force participation does not show an increase.

Senator CHILES. Does not show that.

Mr. DUFFY. Does not show that turnaround. Maybe the strongly preferred good for the near elderly, and for the elderly is leisure, to be retired. If you have to make that choice of retirement or no, then you are better off, in my estimation, in keeping people engaged, using their earned resources, using their own labor and guaranteeing their future retirement through their own efforts, rather than reducing them to a more penurious retirement dependent on social security and confronted with the ongoing problem of income adequacy thereafter.

So I think the bare facts of it is that the elderly have made significant economic gains in the late sixties and into the seventies. In the future these gains will be reversed in a relative sense. In an absolute sense, we are looking at a period of slow growth or stagnation in elderly income. With the pressure of rising prices, there is little upside for the aged, outside of increased employment for the near elderly and the elderly.

By 1990 there are going to be about 17 percent fewer teenagers than there are today. There will be many employment opportunities for the aged either in part-time or full-time work that will occur with this teenage demographic transition. Outside of this change, the number of preelderly will decline. We should be looking category by category, industry by industry, and thinking more creatively about employment prospects for the elderly. We should be engaged in changing institutional and personal attitudes about the suitable time to retire. Behavior needs to be changed, particularly for those who are most vulnerable and on the earlier trend for retirement.

Unless that is done, then with decreasing mortality, increasing lifespan in the retirement period and growing numbers of retirees relative to workers, we are not just looking at a short-term problem reflected in the expected social security deficit. We are talking about a policy that can be dealt with now and benefit both the nonaged and the aged in the future.

The rest of my statement is contained in a report[1] explaining some research that we have recently completed. This research has been expanded for the 1981 White House Conference on Aging out to 2005 to see how various policy and behavioral options will bear. We explore what difference it makes as labor force participation rates change or personal savings rates increase in terms of the future society. This analysis confirms my position regarding the importance of life cycle earnings and employment opportunities in supporting future retirements and lessening the retirement burden.

That is all, Mr. Chairman.

Senator CHILES. Thank you, Mr. Duffy.

I mentioned that the Census Bureau data that was released showed some alarming results. Do you see the findings of the census report as confirming the results of your work? Do you see your predictions coming true already or is this just an expected result following the recession?

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[1] See appendix, item 2, page 170.

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Mr. DUFFY. Well, the recession hurts everyone. It hurts the elderly less than the nonelderly because of the cyclical job losses and the social security system as CPI indexed. With job loss, the elderly with 18 percent—men—and 8 percent—women—labor force participation are not hurt as badly as younger persons. But the wherewithal to support the social security system is affected profoundly by the cycle and I think the movement toward recognizing the importance of these cycles on the social security fund are very worthwhile.

Senator CHILES. For example, this 400,000 elderly people under the Census report that went into the poverty level, do you see that 400,000 as a direct result of the recession or are your predictions beginning to come true already?

Mr. DUFFY. With declining real incomes, we have had a standard-of-living loss with the recession and that translates in some fashion right across the age distribution.

Senator CHILES. In your statement you indicated that during the seventies the overall CPI increased by an annual rate of 7.2 percent, but elderly purchases in items like food, fuel, and health care went up at a rate of 8.4 percent. Some people have advocated using an elderly index to measure the cost-of-living increases. Mr. Myers, and previous witnesses before us, have indicated that they feel such an index would not come out much differently than the CPI. Do you have an opinion on whether Congress should consider a separate index for the elderly?

Mr. DUFFY. I personally feel it would be a bad idea. I do because I feel if you have a separate index for the elderly then you might have a separate index for people regionally or for minorities or for the affluent or for singles. It would be very difficult, and I think undermining, to draw such distinctions.

Senator CHILES. Just start a breakdown of the whole system.

Mr. DUFFY. Yes; I believe that a consensual rule is needed in the guidance of the system. I think that these are improvements planned to update the CPI which will remove much of the distortion. The Bureau of Labor Statistics is active on this issue right now. With the continuing expenditure survey, the quantity weights in the market basket will vary to correspond to current purchases, removing this aspect of the bias.

Senator CHILES. In your statement you state that recent inflation has made debtors wealthier and savers poorer. Since we have encouraged workers for years to save for those retirement years, it is disconcerting to learn that one might have been better off to have been in debt rather than saving. Is a penny saved really a penny lost?

Mr. DUFFY. Ben Franklin is very dead, thank you.

Senator CHILES. Could you be more specific? Could you give me some more examples of how it is going to damage someone to be a saver rather than a debtor?

Mr. DUFFY. Well, I tried to outline those in the full report. My particular statement is that unanticipated inflation basically eviscerates savings. It does so because creditors lend their money out or hold their money at fixed rates and inflation passes them by. Debtors gain. Who are the debtors? Essentially the people who took mortgage debt and bought homes at 8 percent mortgage rates 10 to 15 years ago, and then reaped the benefits of inflation that exceeded those rates. The Federal Government, with its debt and continuing deficits, also gained.

The average elderly has savings and retains a significant amount of these in financial forms, particularly bank savings. Regulation Q disserved the elderly in a major and disproportionate way. They incurred great losses from inflation in nearly all forms of their financial savings during the seventies.

For bondholders, well, you know that the Great Gadsby wanted to go into bonds. Well, that was too long ago and that market has been just taken apart in the last 15 years. If you look at major endowments like Harvard—and note that Harvard has been well managed—and compare the real value of its portfolio today to its value 12 to 15 years ago, you'll discover that Harvard is worse off now despite the fact that Harvard plowed endowment income back in and received substantial gifts during this time. Endowments such as Harvard's example the wealth loss in financial forms over this past decade.

The U.S. Government is a debtor. With inflation, wealth is transferred from households to government as households are net creditors. Unlike Gadsby's bonds or the graduate's "plastics," the key word of the seventies was leverage. Debt worked very well. In the eighties, as we are successful in lowering the rate of inflation, we will probably increase the gains to savers. Certain of these potential gains will accrue to the aged. With about 20 percent of their current income resulting from savings, the wealth gains—or losses—are important to them.

Senator CHILES. Many of us in the Senate are concerned about improving the economy by stimulating some form of more capital formation. As you know, one way to do this is to stimulate more savings by the American people. We see that Japan and Germany both have a higher government debt structure percentage of their GNP than we do, but they don't seem to suffer from inflation because they have tremendously high personal savings that allow them to accommodate that debt structure without having a transfer or without having any immediate evisceration.

If the word continues to get out that it is better to be in debt than to save, we are not going to make much progress toward this kind of goal. Can you suggest any changes that Congress might make that would make it more beneficial for people to save for their retirement and at the same time help us create more capital to stimulate the economy?

Mr. DUFFY. I think there is great need to increase personal savings. Right now consumption is unusually high and savings are low because consumers recognize that it does not pay to save, particularly in financial forms. With inflation and progressive income taxes, negative returns to savings have characterized this period. There are policy alternatives such as index bonds or exempting a larger portion of interest from Federal income tax payments that would have major implications in terms of the savings behavior of households. Certain changes should be instituted.

The interesting thing is that income in the economy is made up of two components, consumption and savings. In the short run and if you raise savings, it comes out of consumption. The short-term economy suffers unless all of this saving is invested. So the immediate effect is likely to hurt the economy somewhat. If you look at the longer term, beyond 3 to 4 years, the economy is served by the higher investment that is assumed to flow from the higher savings. Despite the likely dip, welfare is probably advanced as people rely more on their own resources, including savings, to finance retirement.

Senator CHILES. But don't you recycle those savings pretty quickly? If those savings were locked in a vault and could never be used, it would seem to me that what you say is justified, but if you are putting those savings in and they are recycled quickly enough into housing, into capital formation, you are in effect consuming those savings by virtue of——

Mr. DUFFY. With the lag.

Senator CHILES. With the lag.

Mr. DUFFY. With the lag.

Senator CHILES. Do you think the lag is 5 or 6 years?

Mr. DUFFY. Right now, there is no apparent shortage of capital in the United States. For example, foreign funds are flooding into both real estate and productive investments. There is a feeling by many economists that there is a shortage of savings but no shortage of capital. There is a shortage of perceived profit opportunities for investment, given existing taxes, for most businesses. A rise in savings relative to consumption will depress demand and may adversely affect investment plans in the short run. An investment tax credit is more directed at just that.

Senator CHILES. We have been told by the economists that we have this competition going on for the savings with the Federal Government having the largest appetite to take those savings in order to finance the national debt, and that competition, of course, took away from the capital investor or necessarily made his interest higher and therefore reduced his profit. Now if we stimulate more savings, we necessarily get back to the Japanese or German situation where you do not have the Government attempting to finance itself, taking the major share of the capital that is there, would that not be a form of stimulation?

Mr. DUFFY. Not in the short run. The majority of industrial investment is financed internally through retained earnings and only a minority externally as through equities or bonds.

Senator CHILES. Has that not happened since we got into this period of tighter capital? Would that not change if the capital was there? Aren't we now seeing that new issues don't go very well? We see that companies cannot float bonds any more because it is very hard, you have to be so triple A to get your bonds out. If that capital is there, would financing still be two-thirds internal?

Mr. DUFFY. Well, the capital has to come out of consumption if you are going to look at it as a closed economic system. In the short run, we are now looking at a renewed recession, particularly for the first quarter of 1981.

To increase the capital available, you can reduce corporate taxes—accelerated depreciation or higher investment tax credits—or increase household propensities toward savings—or, Government's proclivity toward deficits. Whether it is done on the corporate side through lower tax rates or it is done on the personal side, again by effectively lower tax rates you will eventually increase the supply of capital and contribute to the needed reindustrialization of America. That happens, but in the short run you reduce consumption and, probably, overall income. So how long does it take? It takes an uncomfortable little while.

Senator CHILES. Would that reduction of consumption in the short run be bringing about a reduction in the inflation?

Mr. DUFFY. Yes.

Senator CHILES. It would.

Mr. DUFFY. Yes. It does reduce inflation. I cannot give you the exact numbers now on what the inflationary impact is from increased savings, but it does contribute.

Senator CHILES. I notice that the thrust of your report is that the best way for us to deal with this problem in these outer years is to adopt policies and try to have the elderly work.

Mr. DUFFY. The near elderly and the elderly, yes.

Senator CHILES. For longer periods of time. We now find that one of the greatest problems that we have is this tremendous youth unemployment that we have in the country, 35 to 50 percent in core city areas, of black and minority unemployed and unskilled unemployed youth. This is a tremendous social problem and a tremendous employment problem and we are trying to figure some way to deal with it.

What kinds of pressures are we putting on that, and do you think the demographics are going to take care of that by the figures you are citing in the nineties, that 17 percent? You said 17 percent fewer teenagers. Is that going to take care of that problem or are we going to run into a crunch as we try to keep the elderly in the work force longer? Will they not be competing for the same jobs, the elderly and the unskilled youth?

Mr. DUFFY. An aggregate analysis of labor markets suggests that young and old don't seem to compete very much for jobs, but I think of instances where they would compete. You are going to find in the future that many of the social problems of the sixties and seventies which are demographic in origin are going to be significantly less in the eighties. One of these is going to be the rate of teenage unemployment. During the seventies, the labor force increased about 2.4 percent per year. In the eighties, this advance will slow to about 1.5 percent.

For example, McDonald's still needs teenagers or others to man or person their counters, and, with fewer teenagers, you are going to find that the near elderly and elderly will be working more and more in fast food chains either part time or full time.

Senator CHILES. Senator Pryor.

Senator PRYOR. What about the earnings test? This is something that we have been interested in on this committee and it is my opinion we should not have any limitations on earnings for the elderly. What is your opinion?

Mr. DUFFY. Well, I think my opinion is that we should reduce the limitation on earnings. I believe we need to gingerly introduce a change, gradually lowering the earnings test's implicit tax rate. Instead of $1 loss for $2 earned, we should move toward $1 for $4 and to eventual elimination. Maybe we could start with a loss of 30 cents on the dollar or 40 cents on the dollar in the short run. There are some financial hitches that would make that move unpopular, but I think that this is the direction in which we need to go. We cannot tax people the way we do at age 62 or 65 because they happen to be those ages and eligible under the social security benefit formula.

Senator PRYOR. But it would not be a drain on the system in any way if the elderly worked full time and drew a salary and——

Mr. DUFFY. And paid social security taxes.

Senator PRYOR. And paid social security taxes. Would that in any way hurt the system?

Mr. DUFFY. It hurts the system because the resultant balance of taxes and transfers is significantly negative, particularly until behavior changes. I have not looked at that literature in a while. Bob Myers can comment more eloquently on that point, but you have a short-term problem. I think the rule should be changed, should allow people not to be taxed as heavily, but you have to take care of the financing problem.

Bob, do you want to comment?

Mr. MYERS. Yes; first is the cost aspects. If the earnings test were removed, it should only be done after age 65. I would hope that it would not be removed before then, because many people aged 62 to 64 who are working might want to take the cash now instead of later. Then when they did retire they would draw lower benefits. The only question is should the test be eliminated after age 65, or instead should it be liberalized after that? Any change will definitely have a cost. Some studies purport to prove that, if the test is eliminated, more people will work, and the added taxes will make up for added benefits. This is just not correct.

There are arguments for eliminating the test. Frankly what I would prefer is what I just said, either raise the amount or make the reduction for earnings beyond the exempt amount less than $1 for every $2 earned. I think that there should be a test, and I give my own example. I am over 65. I think that it would be a great waste of money if I were to get social security benefits when I have larger earned income now, than I have ever had in my life. That would not make sense to me. A younger worker at minimum wages should not have to pay higher taxes to give me social security benefits when I have had no loss in earnings due to being over 65.

Thank you, Mr. Chairman.

Senator PRYOR. Mr. Chairman, I think for the moment those are all the questions I have.

Senator CHILES. Tom, we will hear from you now.

STATEMENT OF THOMAS C. WOODRUFF, WASHINGTON, D.C., EXECUTIVE DIRECTOR, PRESIDENT'S COMMISSION ON PENSION POLICY

Mr. WOODRUFF. Mr. Chairman and Senator Pryor, I appreciate the opportunity to testify before your committee again, today, regarding the social security programs and the changes that may be necessary in the coming years to keep the system solvent. This series of hearings could not have come at a more important time.

Over the years, as the Nation's programs have expanded, pension coverage and payments have become more significant, conflicts over both have increased proportionately. We can expect that these conflicts will be exaggerated by the massive shifting of older workers into retirement, which is about to take place. This increase in the retirement age population will come just as the future labor pool of younger workers—that is, the workers who have traditionally supported the retired population—begins to shrink.

While I regret that I was unable to participate in your November 21 hearing, I submitted testimony which provides extensive material developed by the Commission on the demographic issue. This material includes statistics on the changing age structure of the U.S. population. The main thrust of that testimony is that we cannot afford to adopt a wait-and-see attitude toward the impact of the large aging population on our retirement programs. We believe the future age structure of the population could have a severe impact on these programs, especially those that operate on a pay-as-you-go basis like social security. We need sufficient leadtime for many of the reforms that have to be made. Procrastination can only result in discriminatory and harsh solutions that would seriously affect large segments of our population.

I have been asked today, both to quickly review the Commission's tentative recommendations on social security as well as the Commission's views on the role of social security in the broader context of retirement income programs. My remarks are based on two interim reports issued by the Commission. I would ask that a copy of the second interim report, issued on November 18, be entered in its entirety in the record.

Senator CHILES. Without objection, it will be made a part of the record.[1]

Mr. WOODRUFF. The Commission endorses the important role that the system has developed in providing baseline benefits to generations of older Americans. We are committed to efforts which guarantee that social security will be able to continue to meet its fundamental commitments to the Nation's elderly.

We also believe that the social security benefit structure should be closely examined. A benefit structure designed to deliver retirement income payments to a typical retired family or individual in the 1930's may not necessarily be appropriate in the 1980's.

As we look at social security problems today we must also be aware of the fact, that we are looking at a mature system which has performed much the way its original planners intended it to with respect to coverage and delivery of benefits. Today more than 90 percent of the work force is protected by the system, and approximately 95 percent of married couples 65 and over receive social security.

Currently the social security benefit structure embodies concepts of individual equity and social adequacy. The Commission, in its first interim report, endorsed these dual characteristics of the benefit structure.

Our initial interim report also outlined several policy options which are being given serious consideration:

First, the Commission is leaning toward an earnings-sharing approach to social security which would help achieve the equal treatment of men and women.

Second, the Commission indicated that elimination of the earnings test might be recommended as an inducement to encourage employment of older workers.

And finally, the Commission felt that if the social security earnings test were eliminated, social security contributions and benefits should

[1] See appendix, item 1, page 105.

be treated the same as employee pensions for tax purposes. This would mean that worker contributions to the system could be deducted. Ultimately, benefits would be subject to taxation. In our opinion this would eliminate one of the problems Bob Myers mentioned in his comments in response to a question from Senator Pryor. Under our proposal higher income individuals would have a very high tax rate applied to the social security benefits and you would not have the problems he mentioned.

The Commission's first interim report also indicated that the social security normal retirement age ought to be raised in the future. The need for this increase is based mainly on improved longevity, demographic projections, and the effect of these trends on future financing costs of social security. I concur with Bob Myers and believe that the Commission in considering this issue, felt that the demographic and lifestyle considerations were equally as important as a financial consideration.

The second interim report spells out a specific formula which would lead to a gradual increase in the retirement age to 68 by the year 2012. The new normal retirement age would be phased in after the turn of the century. Our second interim report also tentatively endorses raising the early retirement age for social security from 62 to 65 at the same time the normal retirement age rises. I would like to add also that we have made recommendations with regard to normal retirement age under private pensions, civil service retirement in that report as well.

In regard to the social security benefits structure, the Commission's latest report also calls for a Commission study of proposals to extend the social security minimum benefit structure and a study of options to reduce the social security averaging period used in calculating the primary insurance amount. We are also examining some increase in the supplemental security income program.

The Commission feels that, taken together, these incremental changes in the system's benefits structure would assist low-wage earners and it would help workers with irregular working careers. I should also point out that the Commission rejected changes in the social security cost-of-living adjustments which would reduce those adjustments for retirees, both with respect to the computation of the basic benefit and in the computation of the postretirement benefit.

The Commission noted in the second interim report that the basic benefits provided by the system should be protected against inflation using the current methods. However, the Commission did express concern about the appropriateness of the current CPI in providing an adequate measure of cost-of-living increases, and we have asked the Bureau of Labor Statistics to conduct a study of whether a separate index for the elderly would be appropriate. We did indicate in both reports that our review of the data indicates that the differences may not be significant in the long run, but we felt that since this was such an important public policy issue, the Bureau should conduct a full and thorough analysis of the effects of the separate index for the elderly.

In considering the issue of whether we should go to some form of partial indexing for the elderly, I think the Commissioners were guided by two impressions of indexing and cost-of-living protection

for the elderly. One is that those retirees who currently have both private pensions and social security already are facing partial indexing. The data that we have been able to accumulate over the past 2 years indicates that most private pensions do not provide full indexing, so that in combination, retirees with pensions already are virtually indexed. The other factor, of course, is that many of the elderly are dependent on savings which, as Mr. Duffy mentioned, is losing ground with regard to its value because of current inflation rates.

The Commissioners also, at least on a tentative basis, voted not to provide partial indexing of the social security benefit as they felt this would primarily affect those who are dependent on social security alone. According to our data, these individuals have the lowest income of the elderly and the Commissioners felt that at this time it probably was not appropriate to change horses in midstream.

To date, the Commission has addressed primarily social security's long-range financial crisis that threatens the system after the turn of the century. I expect that we, in looking both at indexing and other issues, will come back to the shortrun problems in the final report that will be issued in February, since those are the issues that Congress will no doubt be addressing as you reconvene in the next session.

Certainly our retirement age policy recommendations are related to the longrun financial crisis threatening the system. The Commission is also studying alternative financing methods for social security, but at this time the Commission has rejected the use of a value-added tax and the use of revenues from a form of windfall profit tax as a form of providing supplements to social security.

But the Commission believes that solving our retirement income problems in the longrun will undoubtedly mean going beyond the social security system itself. I testified before this committee earlier this year regarding the development of a two-class system of retirement in this country, wherein one class of worker today relies almost exclusively on social security for their retirement income, while other classes of workers can expect an employee pension to eventually supplement their social security benefits.

Our studies indicate that employee pensions represented in many cases the difference between the marginal retirement income standard of living and adequate economic security. The Commission has been committed to a balanced program that would include social security and employee pensions and personal initiatives for retirement. While we support the original purposes of social security, we believe that much more needs to be done in terms of expansion of private pensions. Further, we are studying ways to encourage savings specifically targeted for retirement. We believe that employment of older workers ought to be promoted as a matter of national policy.

Perhaps the most important aspect of the Commission's first report was the decision to give serious consideration to a recommendation which would require every employer to either maintain or contribute to a funded minimum pension plan for their workers. We are studying policy options which would allow the minimum benefit to be almost immediately vested and fully portable. In that same report, the Commission gave tenative endorsement to a number of tax policy measures aimed at equalizing the tax treatment of pension contributions and

benefits, for both employers and employees. We are also looking at ways of amending the Tax Code to promote individual savings for retirement. Thus, the minimum universal pension proposal is viewed as a means of encouraging expansion of pensions particularly for low- and moderate-wage workers who are most dependent on the social security system. Our tax policy suggestions are designed to supplement both existing and the minimum of retirement income program.

It is generally recognized that younger, part-time, and low-wage workers employed by small businesses generally are not covered by advance-funded pension plans. But many noncovered workers are what we would call mainstream full-time workers, earning moderate income, to place them in or near the middle or median of the earned income.

For example, over half, 51 percent, of the noncovered workers are men and over 70 percent of them work full time in their current jobs. In 1978, the median earned income was $10,500. Approximately 37 percent of the noncovered workers earned between $5,000 and $10,000 and over 28 percent earned between $10,000 and $20,000. These figures have led the Commission to emphasize efforts to promote and expand the advance-funded employee pension programs.

The various retirement income programs in this country have developed separately since 1935 as ad hoc solutions to particular needs at specific historical moments.

We need a comprehensive retirement income policy which confirms with present reality and what we can expect will be the reality of the future. In the past, official statements of philosophy have repeatedly emphasized that social security, the basic element of retirement income, is to be only a floor of protection supplemented by employee pensions and personal initiative.

However, many retirees today find themselves disappointed and frustrated. Future retirees are wary and skeptical. With private pensions and private savings lacking, it is reasonable to expect continued pressures to expand social security beyond its role as a floor of protection, regardless of the economic and social consequences. Unless concerted efforts are made to develop alternative sources of retirement income, including employee pensions, savings, and earned income, the role of social security may become even more dominant in the future, and the financial problems even more severe.

That ends my formal remarks and I would be more than willing to answer questions.

Thank you.

Senator CHILES. Thank you, Mr. Woodruff.

I asked this question of Mr. Myers but I think it bears repeating. Other witnesses have supported the idea of raising the retirement age to 68 sometime in the future. Undoubtedly this change would help the long-term financing problem to a great extent. However, it is not fair to say, as Bob Ball testified to us, that raising the retirement age is a benefit cut, and how do we explain or justify to today's workers that they must pay higher and higher payroll taxes, but then wait longer for their benefits?

Mr. WOODRUFF. Yes, I would like to basically repeat what Bob Myers said. If the Commission ultimately recommends an increase in

retirement age, we are telling the younger workers, workers who have plenty of time before retirement, to plan their own retirement years. We are saying that the social contract is not a social contract for an arbitrary age, it is a social contract for a proportion of your life spent in retirement versus the proportion of your life spent in working. We believe that this concept makes sense and that eventually it would be found acceptable if people understood that you were not changing the rules in the middle of the game but were giving them advance notice.

The full effect of our recommendations would be felt in about 30 years, but would begin to be phased in in about 20 years. It is in that sense a benefit cut in that fewer benefits would be paid out over a person's lifetime, but we think that in combination with promoting greater work opportunities for older workers that this proposal makes more sense in terms of maintaining an individual standard of living throughout their life, than moving to proposals that would cut the monthly benefits payable to individuals but retain the current retirement ages, so that people would have longer years in retirement at lower standards of living.

I think that we need a coordinated policy and we do have time. We have 20 to 30 years to develop this policy of providing greater work opportunities, changing the concept of retirement from one wherein an individual moves from a work career during which he worked full time, with no leisure, to full-time retirement with no work. We think that this concept may need to be changed in the future and that we think, also that it may be possible over the next 20 years to develop these changes.

We heard Mr. Duffy describe the demographic changes and labor force sizes anticipated in the next 10 years. Certainly, unless demographic patterns alter dramatically over what is currently expected, we can anticipate that older workers might even be needed and desired by industry after the turn of the century because there won't be the huge influx into the labor market that we have experienced over the past 10 years with the entry of the baby boom into the labor force.

Senator CHILES. Tomorrow, we are going to hear from one of the most active organizations representing Federal retirees, the National Association of Retired Federal Employees. I understand that the Commission has endorsed two proposals that would be of particular concern to Federal employees. One is universal coverage for all new Federal workers, and two, is raising the retirement age for civil service employees to 65, similar to social security. Could you share with us the reasons behind these recommendations?

Mr. WOODRUFF. Yes. I think that in addressing the retirement age question we made three recommendations, and indicated a study in a fourth area. We made our recommendation with regard to social security. Then we moved to private pensions, and looked at the current regulations governing the allowable retirement age under the private pensions, and recommended that ERISA be amended to provide that plans can prospectively increase the normal retirement age under private plans to age 68 along with the social security retirement age. We then also felt that, except in those cases where it can be shown that hazardous duty, difficult work, overriding public policy concerns, necessitated a retirement program that essentially provided for a full

retirement benefit payable when a person was still in their working years—as is currently the case with current civil service retirement—that except in those cases, we should move consistently across all of our retirement programs to a single retirement age policy. And we did not find overriding reasons with regard to hazardous duty or stress, unusual workloads, and so on, in the Federal civil service, and felt that there was no rational reason for the retirement age being at age 55.

Now we have noticed, in fact that without a change in the law, that over the past several years the actual retirement age in the civil service has increased. The average retirement age under civil service now is age 61, even though the allowable age is 55, so the change at age 65 for most workers will not be that dramatic. We would allow and encourage the continuation of the disability benefits for the truly disabled, so that in those limited cases, those people would not be hurt.

The question of universal social security coverage, we looked at from several different viewpoints. The first one, of course, that Bob Myers mentioned, is the financial consideration. It does not make sense for certain groups of workers not to be contributing to a national social program while other workers must participate. We have asked the funds for assuring an independent retirement and other groups objecting to universal social security to justify why Federal, State, and local workers should not participate in a system that all other workers participate in. Thus far, I must say, that we have not received a satisfactory answer to that question. It seems rather odd, in fact, that most segments of the labor movement support a strong social security system, including the benefit tilt which meets social adequacy goals, but in testimony before our Commission, the Fund for Assuring an Independent Retirement has stated that they have problems with this benefit tilt and we don't quite understand the justification for that. You might ask them, if they have the opportunity to testify here.

In addition to the financial questions and the equity questions, the Commission also feels that there are certain benefit design problems with not having a universal social security coverage. For instance, the members of my staff who are all currently Federal employees, and many of whom will leave the Federal employment next May, will have a 5-year period in which they are not covered by the disability insurance provisions under social security, even if they find employment in the private sector and begin paying into the system.

There are other cases of some benefit gaps on disability and survivor benefits that occur for workers who are not covered. And there is the other concern which relates to the financial question of so-called windfall benefits accruing to career noncovered workers, wherein after a full career covered by a pension plan that is designed to largely maintain a standard of living in retirement, workers then leave after 30 years of employment and become employed for a short period of time, qualifying for minimum benefits under social security that are designed primarily for lower wage workers. This benefit problem is one that would be more easily resolved, we believe, under universal coverage than under some sort of patchwork approaches that others have proposed.

Senator CHILES. In your recommendations, do you provide for that? Do you recommend that the retirement age for civil service employees

go to age 65? Is that to be prospective for the new workers coming on or is that a phase-in?

Mr. WOODRUFF. In the words of the Commission, they recommended that it be phased in, that it would apply to workers currently employed, as well as those who enter into service in the future.

Senator CHILES. In your second interim report, the Commission has directed your staff to study the merits and effects of transferring part of the social security program to general revenue financing. I presume that means financing hospital insurance through general revenues. At our first hearing, Bob Ball spelled out a very interesting approach and said that the 1979 Advisory Council recommended going this route. Could you tell us just what the Commission staff plans to do in getting into the question of general revenue financing?

Mr. WOODRUFF. I think the tone of the Commission's report was that if they could, they would like to avoid general revenue financing under social security unless such funds would be specifically targeted. On the general revenue financing questions they were very concerned that we not lose some of the fiscal discipline that the payroll tax financing provides. Although they felt that there might be some need for targeted financing and certainly the HI program is one target for such general revenue infusion. There are some other smaller programs that we are looking at that might be a source of general revenue.

In addition to these transfers, they rejected, at least initially, the concept of having the benefit tilt under social security financed through general revenues. The reasons for their rejection of this proposal were twofold. One group of Commissioners felt that that would lead to excessive benefits under the program and another group of Commissioners felt that it would lead to a reduction in the level of benefits under the program, and since they could not agree, they have decided not to adopt that recommendation, so that our current study is limited to HI and some of the other nonannuity related programs under social security.

Senator CHILES. As you know, the recommendations of the 1979 Advisory Council to tax social security benefits was met with a wave of protest rarely equaled on Capitol Hill. The Commission apparently has not been scared away. As I understand it, the Commission recommends eliminating the earnings test, which is something all of us would like to do, allowing workers to deduct their payroll taxes from their income tax but when they retire have benefits subject to income tax.

What are the arguments in favor of this approach and do you have any suggestions, assuming that it is a good idea, as to how it could be implemented so that people, especially the elderly, could see the merits of such an approach and not feel threatened?

Mr. WOODRUFF. Yes; once the Advisory Council began testifying on their recommendation, I attended those hearings to witness the reception that their proposal received. I guess the approach that we have taken is somewhat different from the Advisory Council, even though it was unclear at least in the language of the Advisory Council report, exactly what, when, or how their recommendation would be phased in. Certainly elderly groups and others felt that the Council was proposing a change in the rules of the game in midstream. In testimony after testimony against their recommendations, a number of witnesses

stated they thought it was unfair because the rules were being changed on them. Current elderly interpreted the recommendation to mean that half of their benefits would be taxed.

Senator CHILES. That is exactly what my mail reflected. They all thought that they were going to lose half of their benefits.

Mr. WOODRUFF. That is in fact what they said, I believe. But what they meant to say was that half of the benefits would be included in taxable income, and that because of the special tax provisions for the elderly, that would mean that most of the lower income workers would not pay any taxes at all.

In our proposal we have taken a somewhat different tact. We said that we were not going to tax benefits, and we don't think any benefits earned to date should be taxed, because those were not the rules under which people participated in the program. Employees paid their 6.13, or whatever the tax rate was in the past, and out of aftertax income. The employer did receive a deduction, but in spite of that, without regard to the equities or inequities of the past, we don't feel that those rules should be changed. However, for the future we believe that it would be more rational to move to a system where employees would receive a tax deduction at the point of contribution for their taxes, and then the entire benefit would be included as taxable income.

Senator CHILES. Has anyone run this? What does the computer say in doing something like this? Do you know anything about that from direct resources or do you know anything about it, Tom?

Mr. WOODRUFF. Yes; we currently have a contract with an actuarial firm to determine which groups of workers are better off and which groups of workers are worse off.

Senator CHILES. Yes.

Mr. WOODRUFF. We are also trying to estimate what the impact of the removal of the earnings test would be, both in terms of benefits to individuals, and the cost to both general revenue and to the social security trust funds, under this proposal. The cost that Bob Myers referred to would be somewhat different if you took both the general revenue and trust fund amounts taken together as a whole. We don't have the results of those studies yet, but as soon as we do, I will be glad to make them available to the committee. Basically we believe the effect of this recommendation will be a long-term tax cut for workers. Low-income workers might even be better off under the system, and that it will permit us to remove the earnings test and just have earnings after age 65 or 68 to be subjected to the same tax structure used for the rest of the population.

Senator CHILES. Where would that phase in or what would be the time frame?

Mr. WOODRUFF. We have not recommended a specific timetable, I hope we will in our final report.

Senator CHILES. I see. But you don't anticipate that it is going to affect people who are presently receiving benefits?

Mr. WOODRUFF. No.

Senator CHILES. We are glad that Senator Pryor has joined us. We are delighted to have Senator Burdick with us, too, and we would like to call on both of you.

Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman.

I neglected a few moments ago to ask unanimous consent that a statement I have be inserted in the record.

Senator CHILES. Without objection, it will be inserted in the record.

[The statement of Senator Pryor follows:]

STATEMENT OF SENATOR DAVID PRYOR

Mr. Chairman, I am pleased to be here today for the second in a series of hearings being held by the Special Committee on Aging on proposals for changes in the social security system.

If there was any question about the need for reform in the social security system, the excellent testimony the committee received on November 21 certainly opened our eyes to the need for immediate review of the system, and to the need for change. the proposals, which ranged from minor modifications to a complete overhauling, presented to us the full range of options for the Congress to review before making needed changes.

Today's hearing, in addition to highlighting the findings of a study on the effect of inflation on the elderly and the second interim report by the President's Commission on Pension Policy, will delve into the complex issue of benefit indexing.

Indexing of a worker's average earnings determines what the beneficiary will initially receive in retirement, and indexing by the Consumer Price Index (CPI) determines what the retired individual will receive in benefit increases.

Recent studies have shown that current methods of indexing may not reflect the effect of inflation on actual wages as accurately as they should. In periods of rapid inflation, such as we've been experiencing lately, using the Consumer Price Index to determine increases in benefits has helped to put a considerable strain on the social security trust fund. We've now come to a point where, at current rates, the fund will be in a deficit situation by 1983. Proposed changes in the benefit formula could save as much as $55 billion by 1985.

Although the formulas used to determine the benefits are complicated, I don't think it takes a computer to figure out that any change in the method of indexing could make a dramatic change in benefits received by the retired of our Nation. For this reason, it's clear that Congress must review the different proposals with a fine tooth comb and weigh the effects before deciding the fate of current indexing formulas.

Mr. Chairman, I personally appreciate the opportunity to hear such valuable testimony, and to gain additional knowledge on such an important topic. I think the committee has done a great service to its members and to the entire Congress for pursuing these hearings, and look forward to today's testimony.

Senator CHILES. We want to say that we regret that our Republican members were not able to attend today, they got involved in a caucus that is going on and so they have been unable to attend.

Senator PRYOR. Mr. Chairman.

Mr. Woodruff, maybe you discussed this, I got called away a few moments ago to the phone. I am alarmed about the figure that only 42 percent of all the private sector workers are protected by pensions in their current jobs. Is that a correct figure?

Mr. WOODRUFF. Yes; that includes full- and part-time workers. If you look at workers over the age of 25, that number increases to 48 percent, still less than half.

Senator PRYOR. Does that mean they have no protection at all once they reach retirement age?

Mr. WOODRUFF. That means that at their current job they are not a participant in a pension plan.

Senator PRYOR. What about social security?

Mr. WOODRUFF. They have social security.

Senator PRYOR. They are participating in social security?

Mr. WOODRUFF. That is right.

Senator PRYOR. What happens to those workers who, as they reach retirement age, have only social security payments coming in—and I'm assuming they are drawing social security benefits at least—how is this group supported?

Mr. WOODRUFF. Well, currently only about 28 percent of the social security benefit recipients receive some form of employee pension plan. The rest rely on some amount of savings or social security alone. I think the figure is about 27 percent of current social security participants rely on social security alone as a source of income and the average level of benefit payments for social security for that group is around $3,100.

We have taken the results of our household survey, which was what you were quoting, and the 1979 "Current Population Survey," and have tried to then forecast the eventual benefit entitlements under the system. We have currently published those forecasts out beyond 1990, and our figures indicate that under current scenarios, that pension and benefit entitlements will only increase to about 30 percent of the entire population by 1990. We have some indications that a larger proportion of people, new entrants into retirement, are covered. About 37 percent have some benefits. We have to realize that some of these benefits are very small. Many small employers have 3-, 4-, and 5-year vesting in their pension plans so some of the retirees are entering retirement.

Senator PRYOR. Let's consider the case of a single individual who retires at age 65 and starts to draw social security and is not involved in any other pension program. This individual has a yearly income of, say, $3,200. What other Federal programs would that individual be entitled to at this point—for example, SSI, food stamps, and so forth?

Mr. WOODRUFF. Again it would depend. There are a number of programs like food stamps, housing assistance, and perhaps some programs on the State or local level that an individual might become eligible for, and certainly at least our assessment of these in-kind benefit programs is that they are fairly efficiently targeted toward the lower income population.

Senator PRYOR. My next question is this. Have those benefits risen to the point where they serve to destroy the incentives for participation in a private pension program or the social security system itself, and especially in the case of younger workers, who have concerns about the future of the social security system? Have we destroyed the incentive for that individual to participate in the social security system?

Mr. WOODRUFF. In combination with the earnings?

Senator PRYOR. Yes.

Mr. WOODRUFF. Yes, I think that overall I do see that there is some disincentive there to participate. The earnings test applies only to earned income and the current permissible levels of earnings would significantly increase a low wageworker's income in spite of the earnings test. You might consider raising that test in the short run to alleviate some of this.

Senator PRYOR. I want it perfectly understood that I am not advocating doing away with any of those particular benefits, but I do wonder if, as some people look toward retirement, they don't just assume they will be eligible for food stamps and other benefits from

the Federal Government, and therefore don't think it is worthwhile to participate in social security or other retirement programs.

Mr. WOODRUFF. Yes, I think that the Commissioners both in the first report and in this latest report have indicated, very clearly, a preference for direct retirement programs and direct retirement savings programs to provide sources of income for the elderly, rather than these in-kind benefit programs and other welfare-related programs. They would prefer in the future to have us shift our emphasis away from some of the in-kind benefit programs and toward a program like our minimum universal pension proposal which all workers will be entitled. This of course, would be in combination with social security and targeted retirement savings incentives, so that in the future we could become less dependent on these in-kind programs with means or asset testing.

There is a stigma attached to any nonearning-related program in this country, and I believe that there are a number of people out there who have full work careers, who, because they are either in the lower segments of the labor market, or women who have family responsibilities in periods of their lifetime that may make them ineligible under current rules for pension entitlements. Such workers would by all other definitions, have been considered a career worker. So we would like to change some of the rules and make the programs themselves that are directly income related more prominent, and maybe we could become less dependent in the future on nonearnings-related programs.

Senator PRYOR. Thank you, Mr. Chairman. That is all the questions I have.

Senator CHILES. Senator Burdick?

Senator BURDICK. I am sorry I didn't hear the first part of your testimony but I have your written statement here. Just one question I would like to ask about.

Barbershop magazines carry a lot of stories now about raising the retirement age up to 68, and you just stated there is no intention to change the maturity date of anybody on the social security role at the present time. Is that right?

Mr. WOODRUFF. I think, Senator, that the proposal that both I and Bob Myers mentioned would take effect for workers retiring after the year 2000. Members of the so-called baby boom age, those under the age of 45, would be partially affected and those under 35 who would be fully affected—who would have essentially 20 years' notice that the rules were being changed somewhat. The general principle is that people should have sufficient advance notice to prepare for their retirement. I think 20 years in the case of the beginning of the phase-in and 32 years for the full effect of the phase-in is adequate time for individuals to plan for their retirement.

Senator BURDICK. Then I misunderstood you to start with. Now you say for some of those on the social security programs right now would have their benefits changed by having the retirement at 68 instead of 65. Have you any legal basis for that change?

Mr. WOODRUFF. As far as we are aware there is no legal problem.

Senator BURDICK. You mean I can start a problem when I am 35 years of age and at the time I am making my contributions believe that

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I am going to retire at 65—you mean to say you can change the rules if I made a contract?

Mr. WOODRUFF. My understanding of the Social Security Act is that Congress is free to change the benefit levels and the financing structure at anytime and in both directions. It can both increase benefits and——

Senator BURDICK. Is that written into the act?

Mr. WOODRUFF. It is my understanding that it is.

Mr. BURDICK. Then I am learning something. I didn't know it was there. I just assumed that you made a contract and you made your first payment to the fund.

Mr. WOODRUFF. I guess there has been some confusion over what the social contract is. I believe that the statistics are that in the period from 1939 to 1941, when the Social Security Act was taking effect, life expectancy was about 3 years less for those at age 65 than it is currently. So an argument could be made, though I have not heard it, that the social contract has been modified upward for workers without changes.

Senator BURDICK. You are not taking any property away when you modify it upward but when you modify it downward then this is a different story.

Mr. WOODRUFF. What we are saying is that what we expect, given current mortality trends, that by the year 2012, we can expect further increases in life expectancy. Basically, though, it was implicitly part of previous laws, we would like to have a principle explicitly adopted that the normal retirement age would relate to a constant proportion of a person's lifetime in retirement versus at work. The best estimate that we have right now, and one that we feel is not that traumatic, in fact does not even fully take into account increased life expectancy since 1939, would be a fairly modest increase of 3 years over a 32-year period. I understand your point.

Senator BURDICK. I am not arguing this with you, it might be desirable to do this. My question is: Is it legal to do it? Can you legally change the contract? That was my only question.

Senator CHILES. Mr. Myers, do you want to comment on that?

Mr. MYERS. Yes, Senator Burdick, I might go into that a little more. Actually in the past there have been a number of instances when the Congress has deliberalized social security benefits. Most of the changes have been in the other direction, but as you will recall in 1977, there were three provisions there that cut back the benefits. Furthermore, even in civil service retirement, where the employees contribute 7 percent and the Government contributes quite a bit more, there have been times when the benefits have been legally cut back.

You will recall 4 or 5 years ago, in the automatic adjustment of benefits under civil service retirement, there was a so-called 1-percent kicker, where the benefit was increased by the CPI rise plus 1 percent. That 1 percent was taken away in the future. There was nothing done to take it away from people who had already gotten it in the past. As I understand the legal basis, the Congress can change the system in any way. However, I would hope that we would always protect accrued rights and only affect future conditions.

Senator BURDICK. I agree with you. A future employee starts out with a new contract, but to people who have been on the rolls for 15,

20 years on a certain contract they are claiming now that that can legally be changed?

Mr. MYERS. Yes, Senator. This was done under civil service retirement, where a person retired in 1970 and at that time expected the adjustment for changes in the cost of living to give the change plus 1 percent. This was done for a few years, but in about 1975, Congress said that in the future you will get only the straight CPI increase, and you won't get that 1 percent. Congress did not go beyond that. Legally, it could have legislated that people who got the 1 percent in the past would have that taken away. Congress did not do that. It rightly didn't do that but legally could have gone that far. In fact, there were some bills introduced that would have done that.

Senator BURDICK. Have any of these examples that you have given now ever been tested in court?

Mr. MYERS. In social security, the deliberalizations have occurred. There have been relatively few and they were done for very logical reasons. As far as I recall in social security, it has never been tested. I understand that some of the civil service groups have thought about testing it. Tomorrow when you talk with the National Association of Retired Federal Employees, you might ask that question, namely, if they have ever thought about testing the legality of removing the 1 percent add-on prospectively.

Senator BURDICK. I am not undertaking a position on the program, I am handicapped by being a lawyer and I want to know how you did these things.

Mr. MYERS. I am not a lawyer, but I have discussed this subject with lawyers and with legislative counsels here in Congress. I work often with your Office of the Legislative Counsel. I think that they have all been of the opinion that this was perfectly legal, and there would be no question that would stand up in court.

Senator BURDICK. I was wondering if there was anything in the basic act that reserves the right to make these changes. Do you know of anything? If you can make a slight change, you can make a major change. I understand that.

Mr. MYERS. There is a provision in the Social Security Act, section 1104, which states, "The right to alter, amend, or repeal any provision of this act is hereby reserved to the Congress." A court case which affirmed this power was *Flemming* v. *Nestor*, 363 U.S. 603 (1960). On the other hand, there are instances in some of the veterans' legislation, like that on national service life insurance, where there is strictly a legal contract. Under social security, there are said to be statutory rights, not contractual rights.

Senator BURDICK. It is a statutory right that is triggered by an employee making the contract with the Government. That is a contract right as I see it.

Mr. MYERS. Senator, I am not a lawyer, but I have heard lawyers say, over the years, that because the social security taxes are in a separate chapter—in the Internal Revenue Code—they do not necessarily create any rights to benefits. People can actually draw social security benefits without paying the social security taxes. If the employer, for example, fails to withhold the taxes and then goes bankrupt, the individual still has those wage credits even though no taxes have been paid.

Senator BURDICK. I understand that. I don't want to belabor this point any more, but if you have any more light on it, I would like to know about it because we don't want to proceed in some direction that we cannot legally proceed on. A lot of these things make sense.

Thank you, Mr. Chairman.

Senator CHILES. Do you have something further?

Mr. WOODRUFF. I have one additional point which although I think legally the act permits benefit adjustments, I think in terms of concepts that under social security as I mentioned in my statement it is both an individual equity and a social adequacy program. In sum, it is an income transfer program, unlike an advance funded pension plan, where an individual may contribute an amount and then receive a direct earnings-related benefit from that contribution. There is not that direct relationship though there is somewhat of an indirect relationship between a person's contributions over a lifetime and what they get out of it. Congress is free, because of this dual role of the social security system, to make a determination, if overriding public policy dictates, of different distributions of benefits to people, different income levels for benefits, or different retirement ages.

Senator BURDICK. Well, I didn't intend to pursue this, but based upon your argument now it would be perfectly all right for Congress to cut benefits in half and it would still be legal?

Mr. MYERS. It would be legal, but it would be quite politically unexpedient.

Senator BURDICK. I understand that.

Senator CHILES. If you wish to hear more on this with a somewhat perhaps different flavor, tune in tomorrow at 2 o'clock, when we will resume our hearings in this room. We will hear from James M. Hacking, the assistant legislative counsel for the National Retired Teachers Association and American Association of Retired Persons; Jacob Clayman, president of the National Council of Senior Citizens; Donald F. Reilly, deputy executive director, National Council on Aging, Inc.; Carmela G. Lacayo, executive director, Asociacion Nacional Pro Personas Mayores; Delores A. Davis, executive director, National Center on Black Aged; and Michael C. Nave, president, National Association of Retired Federal Employees.

We will recess our hearings.

[Whereupon, at 11:10 a.m., the committee recessed.]

APPENDIX

MATERIAL RELATED TO HEARING

ITEM 1. AN INTERIM REPORT OF THE PRESIDENT'S COMMISSION ON PENSION POLICY, NOVEMBER 1980, SUBMITTED BY THOMAS C. WOODRUFF

PRESIDENT'S COMMISSION ON PENSION POLICY

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INTRODUCTION

The President's Commission on Pension Policy has been asked by the President and Congress to examine the nation's retirement, survivor and disability systems and to develop recommendations for changes that will address current problems and meet identified goals.

The need for such a comprehensive examination of programs and policies is clear when current problems are reviewed:

- Lack of pension coverage for many;
- Low benefits for some who are covered;
- Excessive benefits for others;
- Lack of coordination among programs;
- Inequitable treatment of women;
- Inconsistent tax policies;
- Erosion of benefits due to inflation;
- Abuses in disability programs;
- Employment problems of older workers;
- Inadequate incentives for retirement savings; and
- Increasing dependency on pay-as-you-go programs.

The list of problems is longer. However, this list is sufficient to show that thorough review and comprehensive recommendations are needed.

This is the second Interim Report to be issued by the Commission. The purpose of interim reports is to provide an indication of the progress that has been made and the broad, long-range policy direction that is developing and guiding the Commission's work.

The tentative recommendations and positions of the Commission expressed in the interim reports are conditional on the results of cost and impact studies of such initiatives. The reports reflect the consensus of the Commissioners, but questions raised by some members with regard to particular recommendations will be studied further. After additional study and discussion, final Commission recommendations to be issued in February 1981 may differ somewhat from those presented in the interim reports.

The May 1980 Interim Report addressed many issues concerning employee pensions. This report concentrates on social security issues. If a balanced program of social security, employee pensions and individual savings is to be available to all workers, steps must be taken to increase the probability that programs reach intended beneficiaries.

The first chapter of the report describes the current relative roles of the various retirement income sources in delivering benefits to the elderly. The Commission recognizes that social security provides an important floor of protection and that it is meant to be supplemented by other retirement income. However, many retirees rely primarily or solely on social security for retirement income and have little or no other income to supplement those benefits.

As possible solutions, the Commission is giving serious consideration to the use of a minimum universal employee pension system, described in chapter 2, and to several proposals that would provide greater security to the low-income aged through the social security system, described in chapter 3. Chapter 4 discusses methods of coordinating employee pensions and social security to ensure equitable, adequate and efficient delivery of benefits. Chapter 5 describes the Commission's tentative recommendations on retirement age policy under social security and other retirement programs.

Many of the research projects and studies that will provide the basis of the Commission's final recommendations already have been completed and others are nearing completion. Preliminary and final results from several of these projects are included in this Interim Report.

CHAPTER I

THE RETIREMENT INCOME SYSTEM

In its first Interim Report issued in May, the Commission expressed concern about the development of a two-class system of retirement in this country. One class fares reasonably well in retirement because it can count on social security, employee pensions and perhaps some personal savings. Another class of retirees has to rely primarily or solely on social security benefits because it is not entitled to employee pensions.

Commission efforts to eliminate the two-class system have been guided by the principle that a balanced program of social security, employee pensions and individual savings should be available to all workers. Commission research and public hearings conducted since the Interim Report was issued in May show that the relative roles of the various sources of retirement income differ significantly according to income levels. At the lower income levels, savings and earnings contribute to retirement income but do not play significant roles. Retirees who have employee pensions to supplement social security are in a relatively better financial position than those without employee pensions.

Commission findings indicate that significant numbers of retirees do not meet the standard of living implied by the intermediate couple's budget developed by the U.S. Bureau of Labor Statistics (BLS).1/ In its May report, the Commission directed study of the BLS intermediate couple's budget as a minimum level of retirement income adequacy and of an appropriate equivalent budget for single people. For purposes of this discussion, 75 percent of the couple's budget is being used as a standard for single people.

1/ Thomas C. Borzilleri, In-Kind Benefit Programs and Retirement Income, Working Paper, President's Commission on Pension Policy, October 1980.

About 60 percent of single people and 36 percent of couples age 65 and over had incomes below that level in 1978. As shown in table 1, about 27 percent of aged single people and 7.3 percent of aged couples had incomes below the official poverty line.

In-kind benefits play a significant role in supporting the elderly who have lower incomes, as shown in table 2. Inclusion of in-kind benefit income greatly reduces poverty among the aged. However, even with the inclusion of in-kind benefits, 36 percent of aged singles and 17 percent of aged couples had income levels below the BLS intermediate budget level in 1978.

The same study shows that in-kind benefits now are a substitute for, rather than a supplement to, retirement benefits. In-kind income in 1978 was received primarily by single people with cash incomes below $5,000 and by couples with cash incomes below $7,000. In addition, it must be recognized that cash and in-kind income totaling $5,000 is not equivalent to cash income totaling $5,000 because the recipient of in-kind benefits has no discretion over how to spend the in-kind portion of income.

The Commission recognizes that in-kind benefits currently are an important source of income for many elderly. However, insofar as in-kind benefits fill gaps caused by deficiencies in delivery of benefits under the social security system, alternative ways to improve delivery should be explored.

The need to supplement present social security benefits is confirmed by data presented in the Commission working paper, Income of the Retired: Levels and Sources.2/ In 1978, nearly one-quarter of all retirement income recipients relied on social security benefits as their only source of cash retirement income, with a total mean income of about $3,100. Of those age 65 and over, over 36 percent of married couples, 81 percent of nonmarried males and 85 percent of nonmarried females received less than the BLS intermediate budget for that year.

Some social security beneficiaries whose benefits are supplemented by income from one other source still fail to reach an income level equal to the BLS intermediate budget level. Table 3 shows that social security beneficiaries at the lower income levels who also receive Supplemental Security Income (SSI), property income or earnings still are likely to have incomes below adequate income levels. Although about 50 percent of all people age 65 and over had property income in 1977 (primarily from interest on savings), over half of those received less than $1,000 and 90 percent received less than $6,000 from this source. In 1978, few aged people at the lower income levels had income from earnings, but almost half of those with incomes of $15,000 or more had employment earnings.

2/ Cynthia Dittmar and Elizabeth Meier, Income of the Retired: Levels and Sources, Working Paper, President's Commission on Pension Policy, October 1980.

Table 1

Adequacy Standards and
Total Money Income in 1978
For Those Age 65 or Older

Adequacy Standard	Single Persons		Couples	
	Adequacy Standard	Percent of Single Persons Below Adequacy Standard	Adequacy Level	Percent of Couples Below Adequacy Standard
Official Poverty Guideline	$ 3,127	26.7	$ 3,944	7.3
Estimated BLS Lower Budget	$ 3,673	38.7	5,514	17.3
Orshansky Update of[1] Poverty Line	$ 4,391	51.1	5,473	17.0
Estimated BLS Intermediate Budget	$ 5,244	61.5	7,846	34.7
Estimated BLS Higher Budget	$ 7,868	80.0	11,596	57.8
Median Income of Working Age Population	$13,680	92.8	22,571	85.3

Total Number of Families	8,510	Total Number of Persons	7,610
Median Income, Families Headed by a Person 65+, 1978	10,141	Median Income, Unrelated Individuals, 65+, 1978	4,303
Mean Income, Families Headed by a Person 65+, 1978	13,754	Mean Income, Unrelated Individuals, 65+, 1978	5,989

[1] The "Orshansky Update" reflects an updating by Molly Orshansky, who developed the original poverty line, including the use of a thrifty food plan rather than an economy food plan.

Source: President's Commission on Pension Policy, working paper, In-Kind Benefit Programs and Retirement Income, October 1980.

TOTAL RETIREMENT INCOME: CASH AND IN-KIND INCOME, 1978, SINGLE PERSON AGED 65 OR OLDER GROSS CASH INCOME CLASS BELOW $5,000

GROSS INCOME CLASS	NUMBER OF PERSONS IN CLASS (IN THOUSANDS)	CLASS MEAN, PRE IN-KIND CASH INCOME	CLASS MEAN, CASH AND IN-KIND INCOME	PERCENT OF INCOME IN-KIND
Under $1,000	84	$ 500	$3,678	86
$1,000-$1,499	108	$1,250	$4,283	71
$1,500-$1,999	201	$1,750	$4,792	64
$2,000-$2,499	643	$2,250	$5,306	58
$2,500-$2,999	793	$2,750	$5,712	52
$3,000-$3,499	834	$3,250	$6,027	46
$3,500-$3,999	829	$3,750	$6,527	43
$4,000-$4,999	1,029	$4,500	$6,050	26
	4,521		MEAN PERCENT OF INCOME FROM IN-KIND	45

PRE IN-KIND MEAN INCOME	$3,210
CASH AND IN-KIND INCOME	$5,816
PERCENT CHANGE RELATIVE TO MONEY INCOME	81.2

Source: President's Commission on Pension Policy, *working paper In-Kind benefit Programs and Retirement Income.*

TABLE II

TABLE III

SOCIAL SECURITY INCOME RECIPIENTS WITH ONE OTHER SOURCE OF INCOME PERCENT DISTRIBUTION BY INCOME CLASS AND MARITAL STATUS, AGE 65 AND OVER 1978

PRESIDENT'S COMMISSION ON PENSION POLICY

MARRIED

TOTAL	TOTAL	PRIVATE PENSIONS	RAILROAD RETIRMENT	FEDERAL EMPLOYEES PENSION	STATE & LOCAL EMPLOYEES PENSION	MILITARY RETIREMENT	SUPPLE-MENTAL SECURITY INCOME	PROPERTY INCOME	EARNINGS	OTHER** INCOME
Less than $3,000	2,333,163	14	1	1	2	1	6	57	13	5
$ 3,000- 5,999	64,483	8	*	*	2	*	19	39	26	4
6,000- 8,999	670,988	8	1	*	2	1	17	55	12	4
9,000-14,999	777,246	19	2	1	2	1	2	55	10	8
15,000-24,999	572,199	18	1	1	4	1	*	58	13	4
25,000+	181,997	4	*	1	3	*	*	71	16	5
	66,251	3	*	1	*	*	*	84	12	*

NONMARRIED

TOTAL	TOTAL	PRIVATE PENSIONS	RAILROAD RETIRMENT	FEDERAL EMPLOYEES PENSION	STATE & LOCAL EMPLOYEES PENSION	MILITARY RETIREMENT	SUPPLE-MENTAL SECURITY INCOME	PROPERTY INCOME	EARNINGS	OTHER** INCOME
Less than $3,000	4,583,403	8	1	1	1	1	17	57	7	8
$ 3,000- 5,999	1,319,254	3	*	*	*	*	36	46	5	9
6,000- 8,999	2,436,449	9	1	1	1	*	12	60	7	9
9,000-14,999	531,391	17	1	3	2	1	1	59	12	4
15,000-24,999	202,737	5	*	6	2	2	*	74	10	1
25,000+	68,036	*	*	*	*	*	*	98	2	*
	24,535	*	*	*	*	*	*	92	8	*

* Less than 1%

** Other income includes all other source of income not listed, such as unemployment compensation, veteran's benefits, workers' compensation.

Source: U.S. Bureau of the Census, Current Population Survey, Consumer Income, March 1979. Special Tabulations.

RETIREMENT INCOME RECIPIENTS 65 AND OVER TOTAL MEAN INCOME BY NUMBER OF ALL SOURCES INCOME, AGE, MARITAL STATUS, AND SEX, 1978

MARRIED COUPLES

	ONE SOURCE PERCENT	AVERAGE TOTAL INCOME	TWO SOURCES PERCENT	AVERAGE TOTAL INCOME
Social Security	12%	$ 5,556	37%	$ 9,101
Railroad Retirement	10	8,139	43	10,154
Private Pensions	*	-	17	8,738
Federal Civil Service Retirement	5	11,420	24	15,259
Military Retirement	2	4,850	19	11,546
State and Local Government Retirement	1	3,400	19	8,984
SSI	11	3,864	57	4,253

NONMARRIED MALES

	ONE SOURCE PERCENT	AVERAGE TOTAL INCOME	TWO SOURCES PERCENT	AVERAGE TOTAL INCOME
Social Security	20%	$ 2,682	43%	$ 4,987
Railroad Retirement	31	3,808	28	6,739
Private Pensions	*	-	29%	6,002
Federal Civil Service Retirement	1	8,178	29	8,856
Military Retirement	*	-	53	4,539
State and Local Government Retirement	13	4,591	29	8,417
SSI	17	2,431	59	2,973

NONMARRIED FEMALES

	ONE SOURCE PERCENT	AVERAGE TOTAL INCOME	TWO SOURCES PERCENT	AVERAGE TOTAL INCOME
Social Security	20%	$ 2,690	48%	$ 4,598
Railroad Retirement	17	3,651	51	5,127
Private Pensions	1	3,473	22	4,743
Federal Civil Service Retirement	6	10,295	28	7,732
Military Retirement	*	-	34	6,258
State and Local Government Retirement	2	4,505	15	8,239
SSI	20	2,218	60	2,893

Source: U.S. Bureau of the Census, Current Population Survey, Consumer Income, March 1979, Special Tabulations.

TABLE IV

RETIREMENT INCOME RECIPIENTS 65 AND OVER TOTAL MEAN INCOME BY NUMBER OF ALL SOURCES INCOME, AGE, MARITAL STATUS, AND SEX, 1978

PRESIDENT'S COMMISSION ON PENSION POLICY

MARRIED COUPLES

THREE SOURCES		FOUR SOURCES		FIVE OR MORE SOURCES	
PER-CENT	AVERAGE TOTAL INCOME	PER-CENT	AVERAGE TOTAL INCOME	PER-CENT	AVERAGE TOTAL INCOME
41%	$14,025	9%	$22,327	1%	$18,226
34	12,850	11	16,170	1	16,583
62	13,913	18	21,789	2	18,424
46	14,171	22	19,079	4	20,101
48	21,380	19	31,556	12	20,258
56	12,408	22	19,933	3	21,406
26	5,384	4	8,764	1	10,649

NONMARRIED MALES

THREE SOURCES		FOUR SOURCES		FIVE OR MORE SOURCES	
PER-CENT	AVERAGE TOTAL INCOME	PER-CENT	AVERAGE TOTAL INCOME	PER-CENT	AVERAGE TOTAL INCOME
31%	$ 9,104	5%	$13,256	*%	-
36	8,641	5	7,191	*	-
60	9,081	10	14,501	2	10,293
39	11,557	13	23,166	6	8,583
17	6,560	14	22,347	*	-
41	7,813	20	14,545	*	-
15	4,083	8	13,848		

NONMARRIED FEMALE

THREE SOURCES		FOUR SOURCES		FIVE OR MORE SOURCES	
PER-CENT	AVERAGE TOTAL INCOME	PER-CENT	AVERAGE TOTAL INCOME	PER-CENT	AVERAGE TOTAL INCOME
26%	$ 7,247	5%	$10,771	*%	-
22	6,665	9	9,659	1	24,947
60	7,911	15	11,598	1	8,898
48	7,737	16	12,641	2	14,459
45	8,318	21	10,879	*	-
60	9,550	21	12,791	2	16,512
17	3,337	3	4,547	*	-

Source: U.S. Bureau of the Census, Current Population Survey, Consumer Income, March 1979, Special Tabulations.

Those social security beneficiaries who also received employee pensions, however, were very likely to have incomes that met adequate income levels, as shown in table 4. In 1978, only about 28 percent of the retired population age 65 and over received income from an employee pension. For those who did have employee pensions, the average total income was about $10,000.

In addition to the minimum standard of income adequacy goal, the Commission also tentatively endorsed replacement rate goals which would permit maintenance of preretirement standards of living. The rates necessary to achieve this objective by income level are shown in tables 5 and 6.

Further Commission work on improving the various retirement income programs and sources will be guided by the concept of the relative roles of those sources, as illustrated in chart 1. Although savings may not play a significant role at the lowest income level, income from individual effort can be expected to play a greater role as income levels increase. Recent testimony before the Commission indicates that the tax policy recommendations tentatively endorsed in the first Interim Report will encourage such a role. At the lower income levels, Commission efforts will continue to eliminate deficiencies in the delivery of social security benefits, as described in chapter 3. The Commission's report noted that "it may not be wise for this country to rely so heavily on the pay-as-you-go social security system to provide all income for these workers and their families." Therefore, the Commission also will continue its work on alternatives to expand the employee pension system, as described in chapter 2.

TABLE V

RETIREMENT INCOME TO MAINTAIN PRERETIREMENT STANDARD OF LIVING SINGLE PERSONS PRETIRING IN 1980 FOR SELECTED INCOME LEVELS

GROSS PRE-RETIREMENT INCOME	PRERETIREMENT TAXES		DISPOSABLE INCOME	REDUCTION IN EXPENSES AT RETIREMENT			NET PRE-RETIREMENT INCOME	POST RETIREMENT TAXES[4]		EQUIVALENT RETIREMENT INCOME	
	FEDERAL[1]	STATE & LOCAL[2]		WORK RELATED EXPENSES[3]	SAVINGS & INVESTMENTS			FEDERAL INCOME	STATE & LOCAL[2]	DOLLARS	RATIO
$ 6,500	$ 906	$ 97	$ 5,497	$ 330	0%	$ 0	$ 5,167	$ 0	$ 0	$ 5,167	.79
10,000	1,785	223	7,992	480	3	240	7,272	0	0	7,272	.73
15,000	3,259	444	11,297	678	6	678	9,941	0	0	9,941	.66
20,000	5,055	728	14,217	853	9	1,280	12,084	166	32	12,282	.61
30,000	8,926	1,429	19,645	1,179	12	2,357	16,109	1,077	205	17,391	.58
50,000	18,921	3,328	27,751	1,665	15	4,163	21,923	3,153	599	25,675	.51

1. Federal income and social security (OASDHI) taxes.
2. Based on state and local 1978 income tax receipts which were 19% of federal income tax receipts. Does not include property taxes.
3. Estimated as 6% of disposable income.
4. Post retirement taxes are on income in excess of social security benefits which are non-taxable. Retirees without social security benefits would need higher replacement ratios.

Source: Preston C. Bassett, Consulting Actuary, President's Commission on Pension Policy, 1980.

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TABLE VI

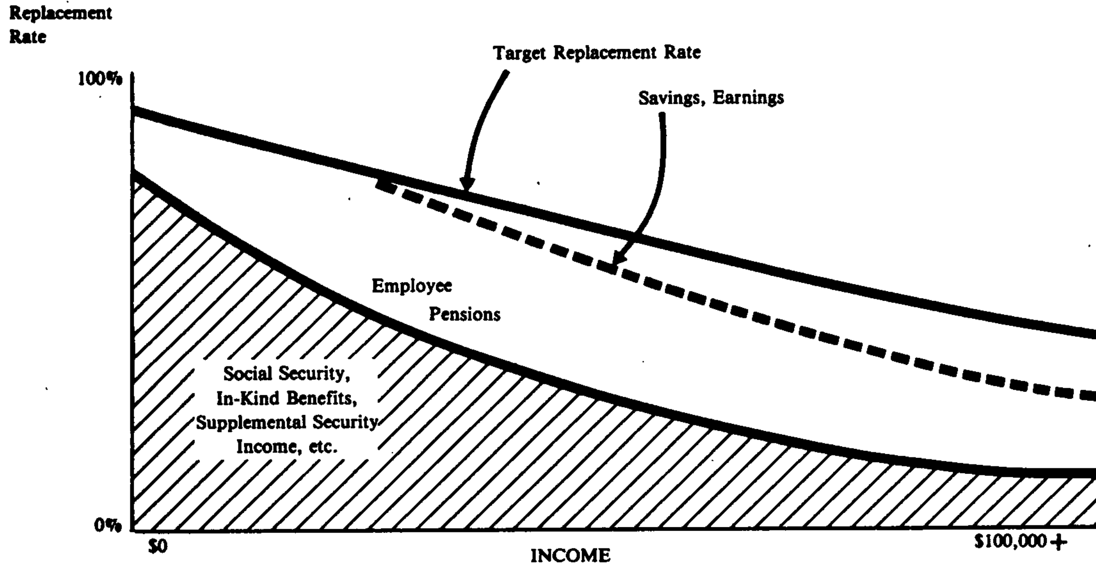
RETIREMENT INCOME TO MAINTAIN PRERETIREMENT STANDARD OF LIVING MARRIED COUPLES RETIRING IN 1980 FOR SELECTED INCOME LEVELS

GROSS PRE-RETIREMENT INCOME	PRERETIREMENT TAXES		DISPOSABLE INCOME	REDUCTION IN EXPENSES AT RETIREMENT			NET PRE-RETIREMENT INCOME	POST RETIREMENT TAXES[4]		EQUIVALENT RETIREMENT INCOME	
	FEDERAL[1]	STATE & LOCAL[2]		WORK RELATED EXPENSES[3]	SAVINGS & INVESTMENTS			FEDERAL INCOME	STATE & LOCAL[2]	DOLLARS	RATIO
$ 6,500	$ 549	$ 29	$ 5,922	$ 355	0%	$ 0	$ 5,567	$ 0	$ 0	$ 5,567	.86
10,000	1,311	133	8,556	513	3	257	7,786	0	0	7,786	.78
15,000	2,550	310	12,140	728	6	728	10,684	0	0	10,684	.71
20,000	3,968	520	15,512	931	9	1,396	13,185	0	0	13,185	.66
30,000	6,986	1,061	21,950	1,317	12	2,634	17,999	53	10	18,062	.60
50,000	15,202	2,622	32,176	1,931	15	4,826	25,419	1,651	314	27,384	.55

1. Federal income and social security (OASDHI) taxes.
2. Based on state and local 1978 income tax receipts which were 19% of federal income tax receipts. Does not include property tax.
3. Estimated as 6% of disposable income.
4. Post retirement taxes are on income in excess of social security benefits which are non-taxable. Retirees without social security benefits would need higher replacement ratios.

Source: Preston C. Bassett, consulting Actuary, President's Commission on Pension Policy, 1980.

THE RELATIVE ROLES OF RETIREMENT INCOME SOURCES



* This chart illustrates the hypothetical, relative roles of the various retirement income sources that the Commission is trying to achieve in its recommendations. The chart is not intended to indicate a precise relationship between the various components.

Source: President's Commission on Pension Policy

CHART I

CHAPTER II

EMPLOYEE PENSIONS

The Commission recognizes that people who receive both social security and employee pensions are more likely to have adequate retirement income.

In its first Interim Report, the Commission concluded that "tax incentives alone may not substantially increase the participation of low- and moderate-income workers and workers employed by small businesses in employee pension plans." Therefore, "serious consideration should be given to the establishment of a universal advance-funded pension system. Such a program could be thought of as an advance-funded tier of social security that would permit contracting out to pension plans that wanted to meet its standards or as a universal employee pension system with a central portability clearinghouse."

The Commission is analyzing the effect of such a system on workers, employers and the economy. A number of options as to how such a system may be designed, and what level of benefits it should deliver currently are being studied.

The identification of those workers who are and those who are not likely to receive benefits from employee pension plans is a crucial first step in the process of strengthening this leg of the retirement income stool. To do this, data on the extent of coverage and vesting among workers of different ages, sex, employment status and work history have been coupled with information on labor force trends and current standards. The results show a great deal about those workers who are or are not likely to receive benefits and why.

Anticipating a need to have the most current and comprehensive data available on pension plan coverage, the Commission initiated a major survey project last year.[3]

In addition, the U.S. Department of Labor and the Social Security Administration sponsored a pension coverage supplement to the Current Population Survey conducted by the U.S. Bureau of the Census. In almost all respects the two surveys yielded nearly identical findings.

The two surveys indicate less than half of all full and part-time private sector workers are covered by pension plans through their present employers.

The Commission survey found that even among full-time private sector workers age 25 and over, less than one-third of the total private work force had pension benefit eligibility (vesting).

Pension Plan Coverage

It is important to carefully define terms used when determining pension plan coverage. The most frequently used definition of pension coverage means current participation in a pension or profit-sharing plan.

Using this definition, the Commission study found that 48 percent of all public and private sector workers are presently covered by some type of pension, profit-sharing or other retirement plan at their current job, as shown in table 7.[4]

Fifty-six percent of all employed men and 39 percent of all employed women are covered by a pension plan, as shown in table 7. Among workers under age 25, 29 percent of the total work force is covered. Table 7 shows that among workers age 25 and older, 53 percent of the work force is covered. Among workers approaching retirement, age 55-64, coverage increases to 57 percent.

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[3] The President's Commission on Pension Policy, the Department of Labor, the Pension Benefit Guaranty Corporation, the Administration on Aging, the Treasury Department, the Small Business Administration and the Social Security Administration are sponsoring a nationwide, random survey of 6,100 adults on retirement income issues. The first wave of the survey was conducted in October 1979 by Market Facts, Inc. A follow-up survey on some questions with the same respondents was completed in October of this year. Final survey analyses on the primary questions relating to the impact of social security, employer pensions and other forms of retirement income on personal savings behavior and capital formation are being done by SRI International.

[4] The Commission survey covers both full-time and part-time workers over age 18. The data presented here exclude the self-employed, who tend to have lower pension plan coverage.

Table 7

Pension Coverage Among Total Work Force

Age, Years on Job, Average Weekly Hours	Percent of All Workers[1]	Percentage Covered By Pensions		
		All Employees	Men	Women
Total	100%	48%	56%	39%
Under Age 25	24.2	29	34	23
Age 25 and Older	75.8	53	61	43
Less than one year on job	12.5	25	33	17
One or more years on job	63.3	61	68	51
-less than 1,000 hours/year	4.5	36	52	26
-1,000 hours/year or more	58.8	62	68	55

[1]These figures are based on an ICF analysis of May 1979 Current Population Survey data. Data in this table include private wage and salary workers and state and local government workers age 16 and over. This table does not include federal employees, the self-employed, unpaid family workers, or workers under the Railroad Retirement Board.

Source: Special Tabulations of Household Survey, President's Commission on Pension Policy, October 1980.

Some suggest that it is more appropriate to describe pension coverage among those employees who currently meet plan participation standards, set by the Employee Retirement Income Security Act (ERISA).[5/]

[5/]ERISA does not require private sector employers to provide pension protection to workers who are under age 25, who work less than 1000 hours a year and who have less than one year of service with their companies. For purposes of the Commission's data, meeting ERISA participation standards was defined as over age 25, with one or more years of service and more than 1,000 hours of work annually with the employer.

For the group of public and private sector workers meeting these ERISA criteria, 62 percent are already covered by a plan, as shown in table 7. It should be noted, however, that less than 60 percent of the public and private work force meets the ERISA criteria of age, service and hours-of-work with their employer.

The incidence of pension plan coverage among private sector workers is less than that of the total work force, according to the Commission survey. Total private pension plan coverage is 42 percent, as shown in table 8. For males, the figure is 51 percent. For female private sector workers, pension coverage is 32 percent, as shown in table 8. For the portion of the private sector work force meeting ERISA minimum age, service and hours-of-work standards, coverage increases to 58 percent, as shown in table 8.

An alternative way to analyze coverage is to consider "covered jobs" rather than "covered people." Some workers not presently covered by private pension plans will ultimately have the opportunity to participate in their employers' plans if they stay on their current jobs and meet the ERISA minimum participation requirements. Table 9 shows that 48 percent of private sector workers are currently covered or may become covered since they are employed by companies that provide pension coverage for workers in their jobs who meet the plan's eligibility criteria.[6/]

Characteristics of Noncovered Workers

In 1979, over thirty-four and one-half million private sector workers were not covered by pension plans on their current jobs. It is generally recognized that younger, part-time, low-wage earners and workers employed by small businesses generally are not covered by pension plans. However, the data summarized in table 10 show that many of the noncovered are "mainstream," full-time workers, earning moderate incomes that place them in or near the middle of the earned income distribution.

[6/] Employee "coverage" includes survey respondents who indicated they were participants in a pension plan, as well as those not currently in a plan but who anticipate they will eventually be included. The Commission used responses from two questions in its survey to derive this figure. Question 26 on page C-6 of the questionnaire asks "to the best of your knowledge, are you a participant, or covered in any way, by such a (pension) plan?" Question 27 on page C-6 asks "if you continue to work on this job, will you eventually be included in any of the (pension) plans?"

TABLE VIII

PRIVATE PENSION PLAN COVERAGE

(active workers, both full-time, and part-time, excluding self-employed)

	PRESIDENT'S COMMISSION ON PENSION POLICY HOUSEHOLD SURVEY 1979			DOL/SSA CURRENT POPULATION SURVEY		
	PERCENTAGE					
AGE, YEARS ON JOB, AVERAGE WEEKLY HOURS	ALL EMPLOYEES	MALE	FEMALE	ALL EMPLOYEES	MALE	FEMALE
TOTAL	42	51	32	43	50	31
UNDER AGE 25	27	33	20	19	22	15
AGE 25 AND OVER	47	56	36	52	60	38
ERISA STANDARDS (more than 1 year of service + 1000 hours)	58	64	48	61	67	50

Source: President's Commission on Pension Policy

Table 9

Private Pension Plan Coverage Using Job Status Criteria[1]

Age, Years on Job, Average Weekly Hours	Percentage of Jobs Covered Covered		
	All Employees	Men	Women
Total	48	55	39
Under Age 25	·33	54	28
Age 25 and Older	52	60	42
-35 hours/week or over	59	64	52

[1]Employee coverage includes respondents who indicated they were participants in pension plans, as well as those not currently in plans but who anticipate they will eventually be included.

Source: Special Tabulations of Household Survey, President's Commission on Pension Policy, Oct. 1980.

Over half, 51 percent, of these noncovered workers are men, and 70 percent of the noncovered worked full-time. While most part-time workers are not covered by pension plans, part-time employment comprises a small part of the total job market. While pension coverage among young workers is very low, approximately 64 percent of the noncovered population is over the age of 25.

Nearly all, 91 percent, of the noncovered are not union members.

Many noncovered workers are employed by small firms. Nearly 58 percent of the noncovered work in establishments employing fewer than 100 workers.

Statistics show a large portion of the noncovered workers earn incomes that place them in or near the middle of the earned income distribution. Twenty-eight percent of the noncovered earned below $4,999 in 1978. Approximately 37 percent of the noncovered earned between $5,000 and $10,000, and 28 percent earned between $10,000 and $20,000 in that year. Median earned income in 1978 was approximately $10,500 in the private sector work force.

Pension Plan Vesting

Even though a person may be a participant in a pension plan, he or she may not actually be entitled to receive a benefit upon retirement. Pension plans often require a participant to be covered by the plan for a number of years before being considered vested, i.e., entitled to eventually receive benefits.

The Commission survey found that of the total public and private working population over the age of 18, only 25 percent are vested in a pension plan provided by their current employment. This figure increases with each age cohort, equaling 32 percent for those age 35 and older and 37 percent for those age 55 and older.

Again, men are more likely than women to be vested, and older workers are more likely than younger workers to be vested.

In the private sector alone, 23 percent of all private sector workers are currently eligible for pensions with their current employer. Twenty-eight percent of all male workers and 17 percent of all female workers in the private sector are vested. Thirteen percent of all private sector workers under age 25 are vested. Among workers over age 25, vesting increases to 26 percent. Among workers over age 25 meeting ERISA standards, vesting is further increased to 30 percent, as shown in chart 2.

Forecasting Future Coverage

The Commission's survey results are based on data collected in October 1979 and portray "snapshot" information about the nation's pension system at one point in time. However, based on comparisons with previous surveys it appears that pension plan coverage has remained static with little expansion for a number of years. In its May publication Preliminary Findings of a Nationwide Survey on Retirement Income Issues, the Commission reported that, based on two Current Population Surveys, private sector pension coverage among full-time workers had increased only two percentage points from 1972 to 1979.

Snapshot surveys, while limited by themselves, can be used along with labor force and pension forecasting models to predict the likelihood of pension coverage and benefit receipt in the future. With this goal in mind, the Commission and the U.S. Department of Labor (DOL) contracted with ICF, Inc. to develop such forecasts.

The Commission/DOL forecasting models indicate that the proportion of the labor force covered and vested in employee pension plans is not expected to increase significantly under current policies. Preliminary forecasting results predict an increase of less than three percentage points in the proportion of the labor force covered by employee pension plans and a growth of only two percentage points in the proportion of the labor force vested in employee pension plans by the year 1990.

This near stagnation of coverage and vesting growth--less than .3 percentage points and .2 percentage points annual growth respectively--is

TABLE X

WHICH PRIVATE SECTOR WORKERS ARE NOT COVERED BY PENSION PLANS?

In 1979, 34,542,000 private wage and salary workers were not covered by a pension plan:

- 51% of these were men, 49% were women
- 70% of them worked full-time, 30% part-time
- 64% were over age 25 and 47% of noncovered were over 25 and have one or more years of service with their employer
- 78% worked in three main industries
  - 31% from trade
  - 29% from service
  - 18% from manufacturing
- 64% worked in four main occupations
  - 19% service workers
  - 58% clerical workers
  - 15% operatives
  - 12% craftsmen
- 91% were not members of unions
- 58% were in firms with fewer than 100 employees
- 16% were in firms with 500 or more employees
- 93% earned less than $20,000 in 1978
- 28% earned less than $5,000 in 1978
- 37% earned between $5,000 and $10,000 in 1978
- 28% earned between $10,000 and $20,000 in 1978

Source: Gayle Thompson Rogers, *Pension Coverage and Vesting Among Private Sector Wage and Salary Workers 1979: Preliminary Estimates from the 1979 Survey of Pension Plan Coverage*. Working Paper Number 16, June 1980; and unpublished tables from the survey, Social Security Administration, Office of Research and Statistics, Washington, D.C.

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due to several factors. Pension plan growth is predicted in those industries, such as manufacturing and transportation, where coverage is already high, as shown in table 11. Most economic forecasts, however, predict that these industries will have a declining share of the labor force in the future. Instead, low pension coverage industries, such as trade and services, are predicted to grow in the future.

Table 11

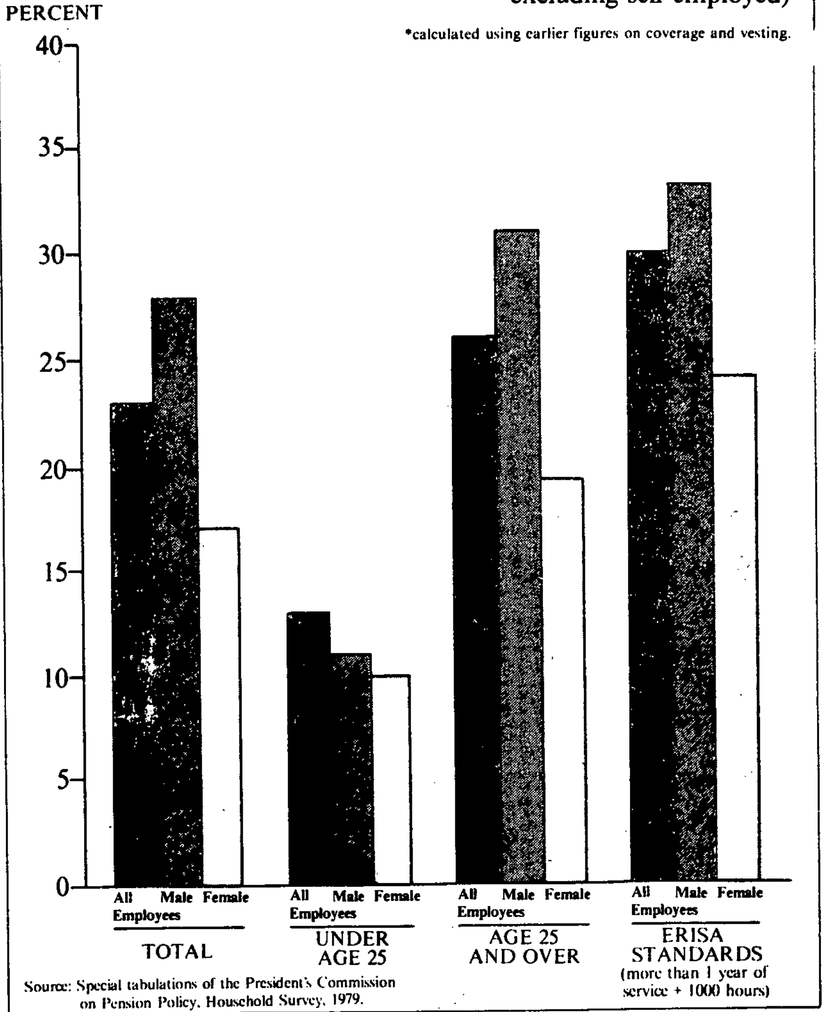
Pension Participation Among Private and State and Local Government Workers Age 25 and Over by Industry, 1979[1]

Industry	Percentage of All Workers (Percentage of Group Participating)		
	Men	Women	Total
Mining	1.5% (74%)	0.2% (67%)	1.0% (74%)
Construction	8.1% (46%)	1.0% (26%)	5.1% (45%)
Manufacturing	32.3% (77%)	19.5% (54%)	26.9% (70%)
Transportation	9.0% (70%)	3.4% (67%)	6.7% (69%)
Trade	16.7% (45%)	17.9% (26%)	17.2% 37%)
Finance	4.6% (57%)	8.0% (51%)	6.0% (53%)
Services	12.2% (41%)	27.3% (28%)	18.5% (33%)
State and Local Government	13.6% (86%)	21.9% (74%)	17.1% (80%)
Other	2.0% (15%)	0.8% (12%)	1.5% (15%)
Total	100% (63%)	100% (46%)	100% (56%)

[1]This table includes non-federal wage and salary workers age 25 and over. It does not include the self-employed, unpaid family workers or workers under the Railroad Retirement Board.

Source: ICF analysis of May 1979 CPS data.

CHART II



The Commission is exploring how both "defined benefit" options and "defined contribution" options could be implemented. Under a defined benefit approach, pension plans would have to meet specified minimum benefit level standards. Under a defined contribution approach, employers would be required to contribute a specified minimum to a pension plan.

The Commission is studying a number of preliminary alternative standards concerning participation, vesting, benefit accrual rates for defined benefit alternatives, indexing, contribution rates for defined contribution alternatives, survivor rules and implementation procedures. These preliminary alternatives, which may be modified as their effects are further studied, are listed in Appendix A.

The Commission is also studying alternatives to the minimum universal pension system (MUPS) described above, including options to require thrift or savings plans with voluntary employee participation and to liberalize current participation and vesting standards for employee pension plans.

Portability and vesting are crucial to the success of any recommendation to stimulate employee plan growth and increase the probability that retirees will have adequate income. The staff is developing options for pension portability and vesting for later presentation.

Economic Effects of A Minimum Universal Pension System

In addition to studying the effect of various minimum universal pension system alternatives on employer costs and benefit delivery, the Commission is studying the potential effects of MUPS on savings and capital markets, adjustments to wages and other fringe benefits, employment and inflation. The Commission is paying particular attention to the effects of a MUPS on small businesses.

These economic effects of MUPS will be compared with the economic effects of alternative approaches to meeting the income needs of the noncovered population such as increasing the minimum benefit levels under social security, as discussed further in chapter 3.

CHAPTER III

SOCIAL SECURITY

The Commission recognizes and endorses the important role of the social security system in providing base-line benefits to generations of older Americans. The Commission's intention in reviewing the system, then, is not to alter that role but to reinforce it.

The social security system can boast of remarkable accomplishments in assuring people of retirement income but some gaps and deficiencies in benefits do exist under the present benefit structure, especially with the changes in family structure that have taken place since the 1930s. Many of these problems are addressed by the Commission's recommendations tentatively endorsed in May: an earnings sharing approach to family benefits, universal social security coverage and removal of the earnings test in conjunction with changes in the tax treatment of social security benefits and contributions so that contributions are tax deductible and benefits are included in taxable income.

Although the Commission recognizes that social security is meant to be supplemented by other retirement income, the Commission is concern that many low-income individuals are not minimally protected. Therefore, the Commission is reviewing the adequacy of social security benefits at the lower-income levels. In addition to giving serious consideration to the use of a minimum universal employee pension system to address this problem, the Commission is considering several proposals that would provide greater benefit security to low-income people through the social security system.

The maturing of the system also has made it clear that social security's financing structure must be reexamined if the system is to continue to meet its fundamental commitments in the long term.

Benefit Structure

The Commission is considering recommendations to expand income protection for the retired through the social security programs. The Supplemental Security Income (SSI) program was enacted in 1972 to

consolidate federal and state welfare programs to the aged, disabled and the blind into a more cost-effective means to target income to the poor. In 1980, the SSI program is expected to cost federal and state governments about $8 billion. Federal SSI monthly benefit levels for July 1980 equal $357 for couples and $238 for single persons. For couples, this benefit level reflects 86 percent of the poverty line and 50 percent of the BLS intermediate budget.

There are several ways to expand the SSI program. Several program provisions could be liberalized, notably the asset test which determines eligibility and the provision which sets the level of income to be disregarded when determining the level of benefits for which an individual is entitled. These levels have not been adjusted for inflation since 1972 when the SSI program was enacted. The Commission also is considering an increase in SSI federal benefit levels to help offset increased costs to state governments due to the liberalization of eligibility standards.

Within the Old-Age, Survivors and Disability Insurance (OASDI) program, workers may qualify for two minimum benefits. Presently all social security beneficiaries are guaranteed a benefit of $122 per month under the regular minimum benefit. In 1978, 3.1 million beneficiaries received the regular minimum benefit.7/ A special minimum benefit is available to long-service workers. In 1980, 86,000 beneficiaries,8/representing one-half of 1 percent of all beneficiaries, are expected to receive the special minimum benefit, equaling between $159 and $289 per month, depending on years of covered employment. Under this minimum benefit, single people with 30 or more years of coverage receive cash benefits that equal 87 percent of the poverty line and 54 percent of the BLS intermediate budget.

The Commission is considering a recommendation to increase the minimum benefit as a means to target benefits to low-income individuals. The Commission notes, however, that unless all workers are covered by social security, it would not be viable to increase the regular minimum benefit. Increases in the special minimum benefit--which applies to long-service workers only--could take place prior to universal social security coverage.

In conjunction with increasing the special minimum benefit, the Commission considered the 1979 Advisory Council on Social Security recommendation to change the formula for determining the primary insurance amount (PIA). This recommendation is discussed in detail in the Advisory Council report to the Secretary of Health and Human Services. In summary, the Advisory Council proposal would provide greater benefits to the very low-paid and the very high-paid, long-service workers, while providing lower benefits to low-paid, short-service workers. The Commission is concerned that the Advisory Council proposal would result in lower benefits for low-paid workers with short careers.

7/ U.S. General Accounting Office, Minimum Social Security Benefit: A Windfall that Should be Eliminated (Washington, D.C.: U.S. Government Printing Office, 1979, page i.

8/ Provided by the Social Security Acturaries.

The Commission also is concerned with the wage replacement rates provided by social security benefits. Table 12 shows current hypothetical replacement rates for idealized, full-time workers and intact couples. The Commission's tentative recommendation for earnings sharing would make the "single-earner couple" schedule inapplicable. Under earnings sharing, all lifelong married couples would show the same replacement ratio as the "equal-earner couple" schedule.

Table 12

Hypothetical Social Security Replacement Ratios

Gross Earnings	Goal[1]	Social Security[2]	Remainder for Idealized Workers and Couples
Single			
$6,500	.79	.57	.22
10,000	.73	.49	.24
15,000	.66	.42	.24
20,000	.61	.34	.27
30,000	.58	.23	.35
50,000	.51	.14	.37
Married-Equal Earner			
$6,500	.86	.82	.04
10,000	.78	.63	.15
15,000	.71	.54	.15
20,000	.66	.49	.17
30,000	.59	.42	.17
50,000	.50	.27	.23
Married-One Earner[3/]			
$6,500	.86	.85	.01
10,000	.78	73	.05
15,000	.71	.64	.07
20,000	.66	.51	.15
30,000	.60	.34	.26
50,000	.55	.21	.34

1 See tables 5 and 6.

2 Based on a continuously employed worker retiring at age 65 in 1980 and, if married, a spouse of age 65. Prior earnings were assumed to increase at 6 percent per year.

3 This schedule would be inapplicable if the Commission's earnings sharing proposal was adopted.

Source: Preston C. Bassett, Consulting Actuary, President's Commission on Pension Policy, 1980.

The Commission recognizes, however, that the hypothetical replacement rates in table 12 do not necessarily reflect the replacement of an individual's preretirement standard of living. If social security benefits are compared with some other measure of preretirement earnings--for example, the last 15 years of indexed earnings--replacement rates provided by social security benefits will naturally be somewhat different.

Earnings histories do not typically follow a regular progression in wage levels. Many individuals, especially women, have less than a 35-year career 9/ and a high variability in earnings is particularly prevalent among low-income workers. 10/ Since earnings histories are highly variable, the wage replacement provided by social security benefits is very sensitive to the earnings base used to compute benefits. The Commission is concerned that the 35-year earnings average may not be the most appropriate measure on which to base social security benefits because the Commission has tentatively recommended income goals based on an individual's standard of living at retirement. The Commission asks the Social Security Administration for assistance in determining the distributional and cost impacts of alternative wage bases for computing benefits.

The Commission concludes that social security benefits, once received, should continue to be fully adjusted to increases in prices. The Commission, however, continues to express concern over whether a separate price index for the elderly might be a more appropriate index for social security benefit adjustments than the current CPI. Proposals to partially index post-retirement benefits are rejected on the grounds that those who rely exclusively on social security should not experience a drop in their purchasing power. Adjusting benefits by wage increases rather than by price increases is rejected because of the uncertainty in the future relationship between price and wage increases.

The Commission also rejects proposals to price index the earnings record in the benefit formula, change the deferred retirement credit and explicitly separate the adequacy and equity features of the social security program.

Financing Structure

Although projections are uncertain, especially in the long-run, it is clear that action will be needed to address financing problems in the social security system. While the current short-run cash-flow problem may yield to relatively simple, painless solutions, the long-run solutions may require sacrifice on the part of covered workers and beneficiaries.

9/ Social Security and The Changing Role of Men and Women (Washington, D.C.: U.S. Department of Health, Education and Welfare, Feb. 1979), p. 231.

10/ U.S. Congress, Report of the Consultant Panel on Social Security to the Congressional Research Service. Joint Committee Print, 94th Congress, 2nd Sess., 1976, p. 64.

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Public confusion over the meaning of short-run and long-run financing problems stems in part from the misunderstanding of the term "trust fund" as it is used under the social security program. The system uses pay-as-you-go financing by which current contributions are used to pay benefits to beneficiaries. The trust fund has only enough money in it at any point in time to pay obligated benefits and administrative expenses a few months into the future.

Currently, there are three trust funds: The Old Age Survivors Insurance (OASI) trust fund, the Disability Insurance (DI) trust fund, and the Health Insurance (HI) trust fund. The first two trust funds primarily deliver retirement- and disability-related income benefits. The third trust fund, HI, provides health-related benefits under the Medicare program. Under current law, if any trust fund runs out of money, benefits may not be paid.

The OASI trust fund is currently experiencing a cash-flow shortage due to the recession and high inflation. It can be expected to experience a long-run financial crisis after the baby boom generation begins to retire because of the changing age structure of the population, as shown in chart 3. The Commission is quite concerned about the future financial integrity of the combined OASI and DI trust funds.

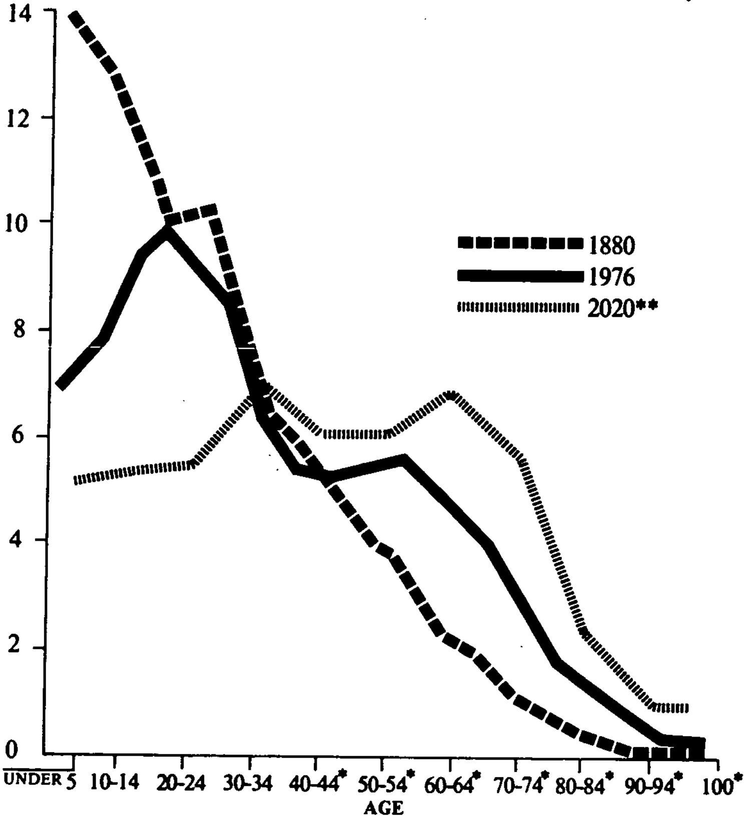
Table 13

Comparison of OASDI Covered Workers With Beneficiaries Per 100 Covered Workers

Calendar Year	Alternative II Intermediate	Alternative III Pessimistic
1945	2	2
1955	12	12
1965	25	25
1975	31	31
1980	31	31
1985	30	31
1990	31	33
1995	32	34
2000	33	36
2005	34	38
2015	40	47
2025	49	62
2035	52	73
2045	51	80
2055	51	87

Source: 1980 Annual Report. (Washington, D.C.: U.S. Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 1980), p. 85.

CHART III



Source: U.S. Bureau of the Census.

PRESIDENT'S COMMISSION ON PENSION POLICY

Currently, 100 covered workers pay social security taxes to support every 31 beneficiaries of OASDI programs, as shown in table 13. In other words, every beneficiary is supported by approximately three workers. This ratio deteriorates by the year 2035 to 52 beneficiaries per 100 workers under intermediate demographic assumptions and to 73 beneficiaries per 100 workers under pessimistic assumptions. In other words, under either pessimistic or intermediate assumptions, we can expect that each future social security beneficiary by the year 2035 will be supported by between 1.4 and 2 workers.

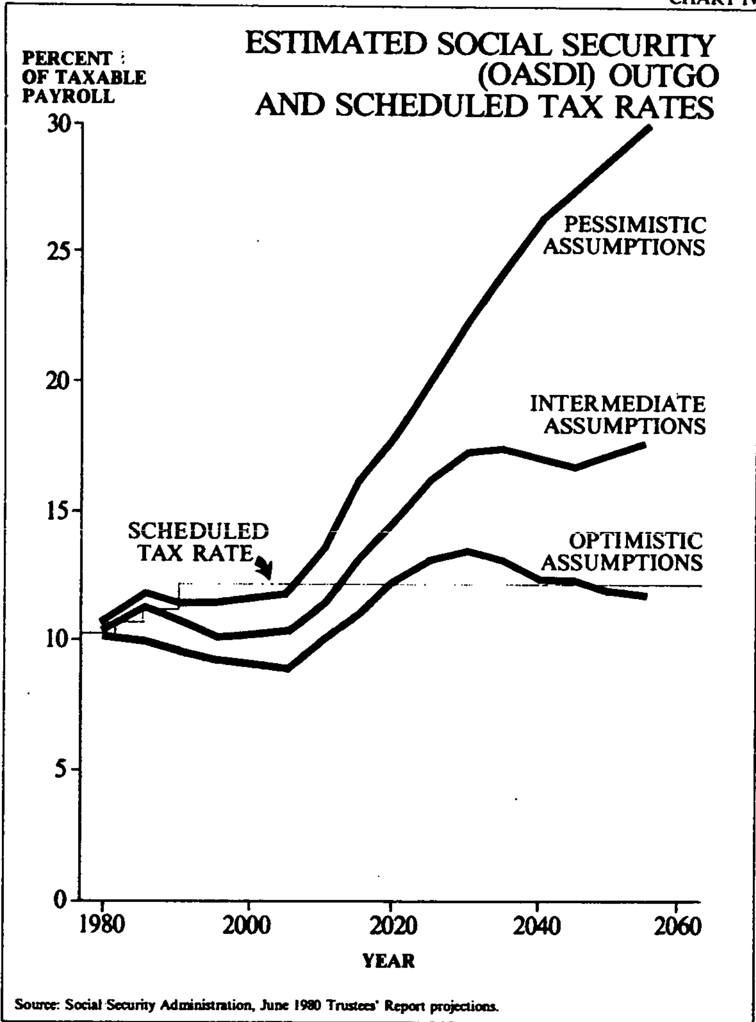
It is unlikely that scheduled payroll taxes will be sufficient to support scheduled benefits. A payroll tax, paid in equal proportion by the employer and the employee up to the taxable earnings ceiling, finances the OASDI social security trust funds. The combined OASDI payroll tax rate is now 10.16 percent of covered payroll and is scheduled to rise to 12.4 percent in 1990. Chart 4 presents the estimated social security OASDI expenditures and scheduled tax rates. The average scheduled tax rate over the 1980-2054 period is 12.22 percent, and this compares unfavorably to an estimated average expenditure (as percent of taxable payroll) of 13.74 percent and 18.39 percent under pessimistic assumptions. If either benefit adjustment or financing solutions to this 1.52 to 6.17 percent long-term actuarial deficit are not found, the problems will be extremely difficult to resolve as the baby begins to retire, for example, over the period 2030-2054, the actuarial deficit will amount to -4.58 percent and -14.20 percent of covered payroll, respectively. Only under the optimistic demographic and economic assumptions will the trust fund accumulate to very high levels, and then decline when the baby boom retires. If the more unfavorable alternatives develop, and they do appear more likely, either more revenue from higher payroll taxes or other revenue sources must be found or benefits must be reduced.

On a cash-flow basis, the OASDI trust funds are expected to have negative flows after the baby boom enters retirement, as shown on chart 5. This results in depleted trust funds under both the intermediate and pessimistic assumptions. Under optimistic demographic and economic assumptions, however, there would not be a deficit. As this chart illustrates, the magnitude of the long-term deficit is sensitive to underlying economic and demographic trends. Most analysts use the intermediate assumptions for forecasts. However, the Commission staff has indicated that the pessimistic demographic assumptions may be more appropriate for policy purposes. The combination of intermediate economic assumptions and pessimistic demographic assumptions would yield forecasts somewhere between the intermediate and pessimistic forecasts shown on chart 5.

The Commission directs the staff to study the merits and effects of transferring some programs not directly related to the provision of retirement or disability income from payroll tax to general revenue financing.

The Commission finds the value-added tax, the windfall profits tax and an oil and gas tax unsuitable as revenue sources for social security financing.

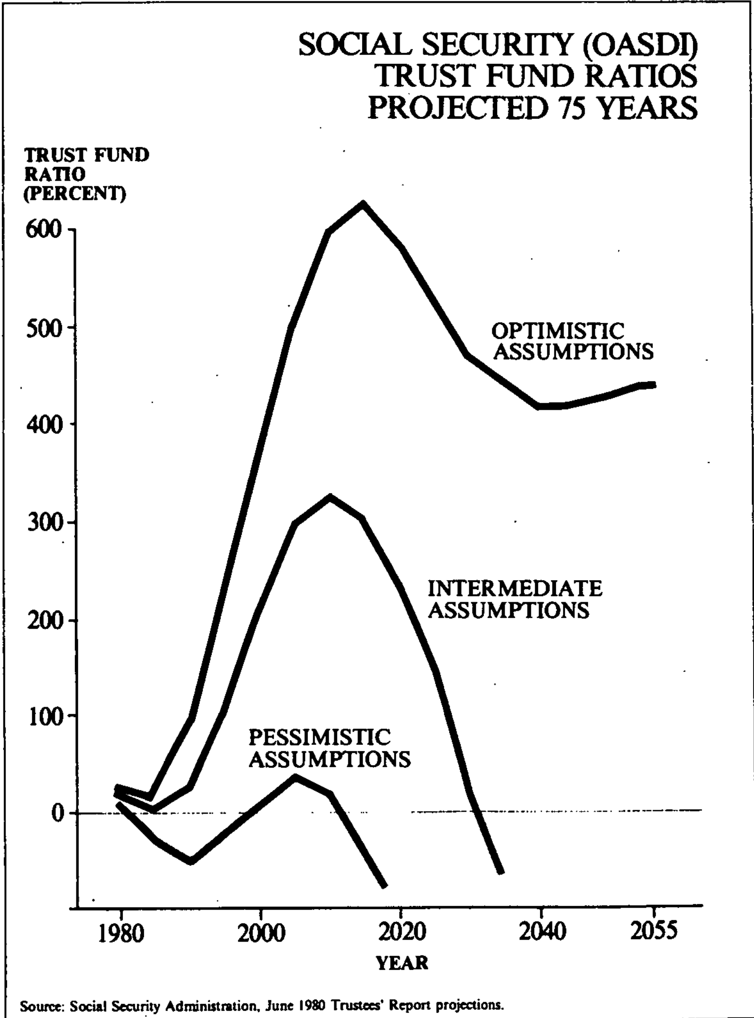
CHART IV



Source: Social Security Administration, June 1980 Trustees' Report projections.

PRESIDENT'S COMMISSION ON PENSION POLICY

CHART V



Source: Social Security Administration, June 1980 Trustees' Report projections.

PRESIDENT'S COMMISSION ON PENSION POLICY

The Commission recommends no further increase in the level of wages subject to the payroll tax beyond those already legislated.

The Commission also reviewed proposals to advance-fund social security. However, while recognizing the desirability of increasing accumulation in the trust funds to levels sufficient to offset the financial drain of the demographic bulge in retirees in the next century, the Commission is concerned that such savings should more appropriately be done by employee pension plans and individuals. Social security trust funds may not be sufficiently isolated from pressures to increase social security benefit levels as the trust funds grow.

CHAPTER IV

COORDINATING SOCIAL SECURITY WITH EMPLOYEE PENSIONS

Coordination of retirement income programs to ensure equitable, adequate and efficient delivery of benefits is essential. Without coordination, gaps and overlaps in benefit protections will persist.

National policy on retirement income goals and the relative roles of the systems in meeting those goals should guide coordination of the systems. In May, the Commission stated that the retirement income system should provide minimally adequate benefits to workers and that it would be desirable that income from all sources be enough to allow retirees to maintain their preretirement standards of living. The relative roles of the retirement income sources favored by the Commission are described in chapter 1.

"Integration" of social security and employee pensions is a technical method that has been used to coordinate employee pensions and social security almost from the beginning of the social security program. However, a number of witnesses at Commission hearings have raised questions as to whether current integration rules facilitate achievement of national retirement income goals or whether alternate methods of coordination would be desirable.

Current integration rules provide a method of coordinating total costs and benefits from social security and employee pensions to reach a target level. Integration is attractive because it allows employers to control costs while continuing to meet the benefit objectives of the combined programs. However, the rules permit the employer to choose from a range of benefit or contribution targets, some of which can result in the reduction or denial of plan benefits to low- and moderate-income workers.

Because of this, the rules have been criticized for being inconsistent with other tax policies formulated to encourage plan coverage of these

workers. It is possible that with continued increases in social security costs, more plans will integrate in the future. Therefore, it is desirable to assure that any method used to coordinate the systems is consistent with national policies.

Integration Rules

There are two general approaches to integrating employee pensions with social security. The first approach, the offset method, reduces the plan pension benefit which otherwise would be paid by some portion of an employee's social security benefit. The maximum proportion of an employee's benefit which can be offset is 83-1/3 percent if the benefit is computed on the basis of the Social Security Act in effect at the time the offset is applied.

The second approach is the excess or step-rate method of integration which allows a pension plan to concentrate on earnings above a certain level when determining plan benefits or contributions. In an excess or step-rate plan which does not consider years of service, the employee pension benefit on earnings above the appropriate covered compensation level cannot exceed 37.5 percent of the plan benefits based on earnings below that level. In a unit-credit excess or step-rate plan, benefits are provided as a percentage of average pay for each year of credited service. For a career unit excess or step-rate unit-credit plan, the percentage applied to each year of service cannot exceed 1.4 percent above the integration level. For final pay unit credit plans, the percentage is 1 percent. In integrated defined contribution plans, the percentage of contributions above the integration level cannot exceed 7 percent plus contributions below that level.

Integrated Plans

The extent to which pension plans are integrated with social security is not known conclusively, although several surveys have suggested that the majority of private plans are integrated. A 1978 study conducted for the Department of Treasury found that two-thirds of all defined benefit plans were integrated, and that small plans were more likely than large plans to be integrated, as shown in table 14. Collectively bargained plans, which constitute a sizable proportion of all private pension plans, generally are not integrated although they may take social security benefits into account in establishing benefit levels. A large majority of corporate, noncollectively-bargained plans are integrated. A 1980 Bankers Trust survey 11/ found that 89 percent of final-pay plans and 77 percent of career-average plans were integrated, as shown in table 15.

11/ Corporate Pension Plan Study: A Guide for the 1980's (N.Y.: Employee Benefit Division, Bankers Trust Company, 1980).

Table 14

Extent of Integration Among Private Pension Plans[1]

	All Plans	Plans With 25 or Fewer Participants	Plans With 26 or More Participants
Integrated	68%	84%	62%
Nonintegrated	32%	16%	38%

1 This sample has a high proportion of large plans.

Source: 1978 survey done for the Treasurey Department by A. S. Hansen, Inc. Based on data on 1,200 of the firm's client plans.

Table 15

Extent of Integration Among 200 Large Corporate Defined Benefit Plans. (Not Collectively Bargained)

Integration Method Used	1965-70 Results	1970-75 Results	1975-80 Results
Final Pay Formulas			
Offset	50%	52%	66%
Step-Rate	38	34	23
Excess	1	1	0
Non-Integrated	11	13	11
	100%	100%	100%
Career Average Formulas:			
Offset	3%	3%	14%
Step-Rate	85	81	56
Excess	3	3	7
Non-Integrated	9	13	23
	100%	100%	100%

Source: Corporate Pension Plan Study: A Guide for the 1980's (N.Y.: Employee Benefit Division, Bankers Trust Company, 1980).

A 1980 survey of small plans conducted for the Commission shows that 67 percent of surveyed defined benefit plans and 31 percent of defined contribution plans are integrated. The incidence of integration varies by plan size, as shown in charts 6 and 7.

The extent to which the use of social security integration is increasing among pension plans appears to be more moderate than generally believed. There has been much speculation that the increasing costs and benefits of social security are contributing factors to the increased use of integration. A Labor Department survey 12/ of 131 private pension plans showed an increase of only four integrated plans between 1974 and 1978. The Bankers Trust survey shows the incidence of integration has increased only slightly among final-pay plans and decreased among career-average plans, as shown in table 15.

The surveys indicate that pure excess plans constitute only a small portion of all plans integrated with social security, as shown in tables 15 and 16. In addition, there has been some suggestion that many pure excess plans are used to achieve integration in conjunction with a second plan that provides a constant percentage of benefits to all workers.

Many of the surveys indicate there has been a shift toward the use of offset integration among integrated plans. According to the Bankers

Table 16

Types of Integration Methods[1]

Types of Integration	Plans With 25 or Fewer Participants	Plans With 26 or More Participants
Pure Excess	3%	1%
Step-Rate	14	22
Offset	84	77

1 This sample has a high proportion of large plans.

Source: 1978 Survey done for the Treasury Deaprtment by A. S. Hansen, Inc., Based on data on 1,200 of the firm's client plans.

12/ Robert Frumkin and Donald Schmitt, "Pension Improvements Since 1974 Reflect Inflation, New U.S. Law," Monthly Labor Review, Vol. 102, No. 4, April 1979, p. 32.

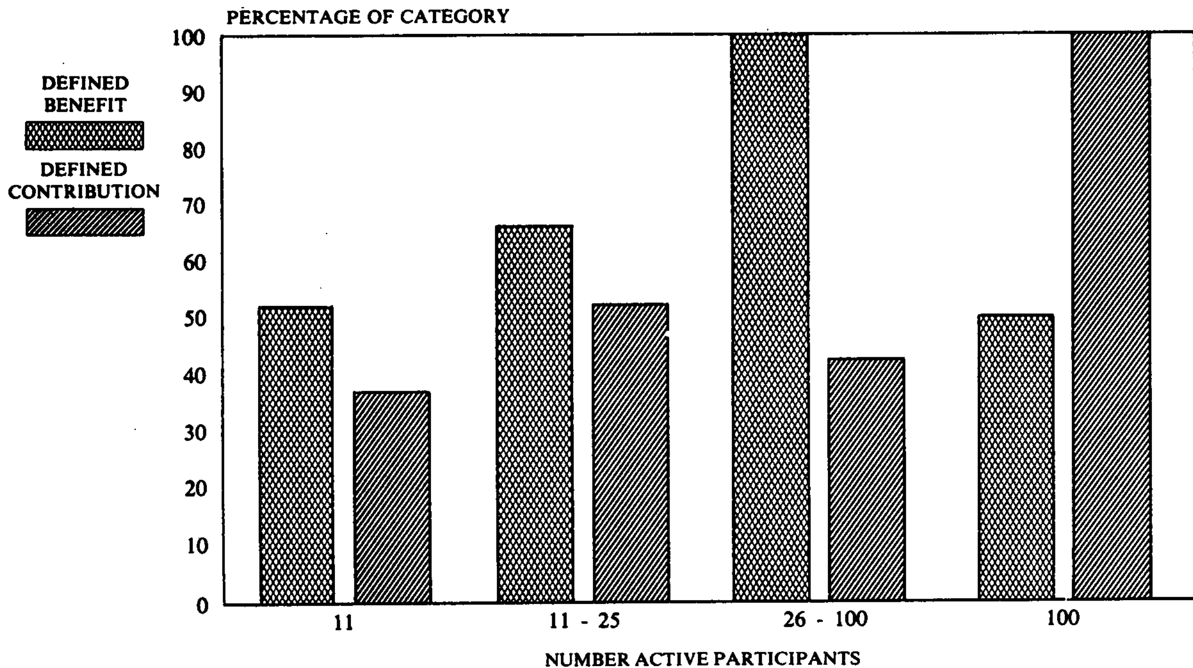
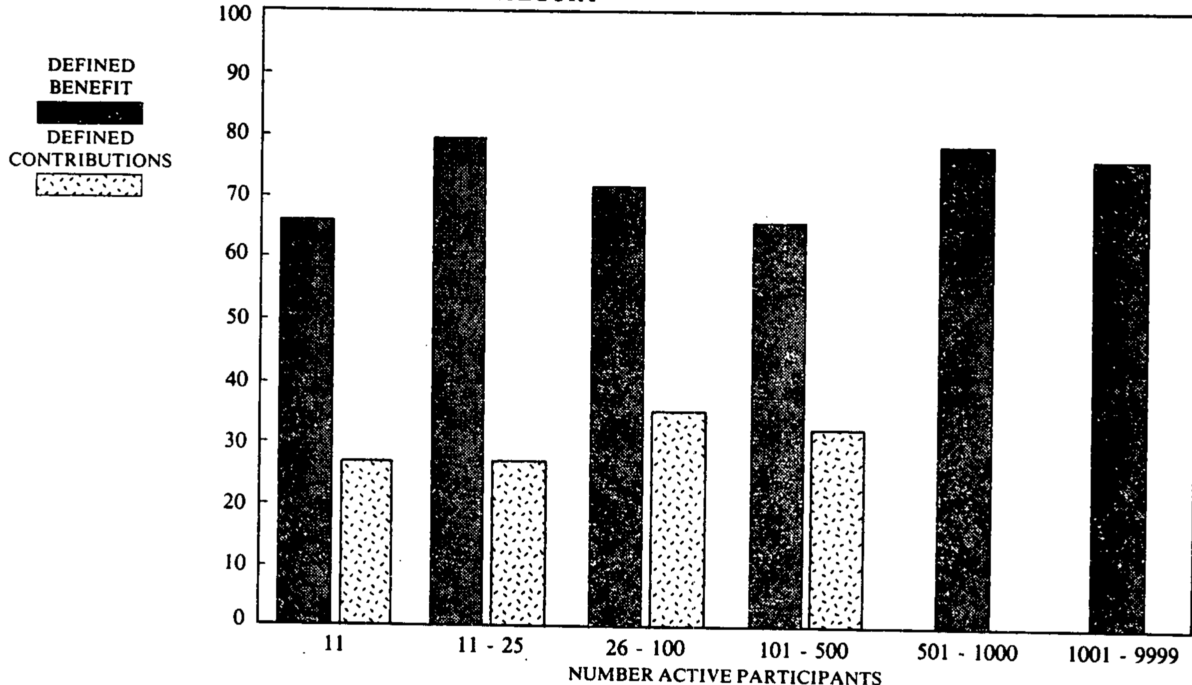


CHART VI



*Source: Special tabulations from American Society of Pension Actuaries 1980 Survey of 2,000 small and medium sized firms

CHART VII

Trust 1975 report, 13/ this trend may have occurred in conjunction with a trend toward final-pay plans. However, it may also be due to the fact that offset integration allows plans to adjust more easily to changes in social security than excess or step-rate integration.

Most surveys indicate that integrated plans do not use the maximum integration levels or percentages. For offset plans, it is generally believed that most plans offset by 50 percent of the social security benefit and very few by the maximum allowable 83-1/3 percent. Because of the different ways these rules are applied and the required adjustments for ancilliary benefits, it is difficult to determine exactly to what extent plans use the maximum allowable formulas. Excess and step rate plans generally use integration levels far below the maximum allowable level.

The Integration Controversy

Certain elements of current integration rules are consistent with national policies while others are not. Generally, national policy has been that social security provides a floor of retirement income to be supplemented by employee pensions and savings. Tax policy is designed to encourage employee pension coverage of low- and moderate-wage employees.

Current integration rules allow employee pension plans to pay proportionately higher benefits to higher income workers and lower benefits to low- and moderate-income workers. The rationale supporting this is that social security benefits provide a higher proportion of preretirement earnings for low- and moderate-wage earners and, thus, they need less income replaced by employee pensions.

Testimony at the October 1979 Commission hearing on social security integration suggested that without integration, total retirement income from social security and employee pensions could exceed preretirement income, particularly for low-and moderate-income wage earners. Indeed, the dramatic improvements in social security benefits over the 1970s enable low- and moderate-income workers to receive social security benefits which may replace a substantial portion of their final years' salaries.

However, social security was not intended to provide all retirement income needs but was to be supplemented by an employee pension. Current social security benefits are not adequate to meet the needs of many lower-income people. As discussed in the Commission's working paper, Income of the Retired: Levels and Sources, the average income in 1978 of those age 65 and over receiving only social security was $5,556 for married couples and $2,688 for nonmarried people.

Under current integration rules, the lowest paid employees, who are least likely to have other sources of income to supplement social security,

13/ 1975 Study of Corporate Pension Plans (N.Y.: Employee Benefit Division, Bankers Trust Company, 1975).

may be excluded from receiving any employee pension benefits and receive only social security benefits even though covered by a plan.

Controversy also centers around the question of who bears the cost of social security and employee pensions. Because social security integration recognizes employers' costs for social security, it is one way employers have to control their overall costs of providing retirement income to employees. Integration rules allow plans to make changes which correspond to changes in the social security system by considering or concentrating only on earnings above those on which social security is based. Therefore, integration rules enable some employers to make a commitment to providing a supplementary pension benefit without undue financial burden.

It is possible that with continued increases in social security costs more plans will integrate in the future. Many employers have argued that without integration the rising costs of social security would force the termination of many integrated plans.

However, some argue that the workers actually bear part of the cost of social security in the form of reduced wages or smaller wage increases. In addition, the derivation of the employers' costs of social security is based on arbitrary assumptions which do not necessarily reflect the employers' actual costs. 14/

Integration may conflict also with the concept of pensions as deferred wages. 15/ The extent to which private sector workers forego wages in order to be in a pension plan is not known. Research on state and local pension plans indicate that public employees do forego wages in order to be plan participants. The extent to which this is true for private sector workers is being explored in a research project underway at the Commission.

The complexity of integration rules is another concern. The Commission agrees that any method of coordinating social security and employee pensions should be easily communicated to employees. This would be particularly crucial if wage-pension trade-offs were found to exist.

The Commission recognizes that any expansion of employee pension coverage must be accompanied by a method of coordinating employee pensions and social security so that no one is excluded from receiving plan benefits. The Commission agrees that one general approach to this would be to change the permissable integration limits.

14/ Ray Schmitt, "Integration of Private Plans with Social Security," Issues in Financing Retirement Income, Studies in Public Welfare Paper No. 18, prepared for the Subcommittee on Fiscal Policy at the Joint Economic Committee, December 27, 1974, 93rd Cong., 2nd sess., 1974, p. 186.

15/ See, for example, testimony of Dianne Bennett before the President's Commission on Pension Policy, October 10, 1979.

The Commission is concerned that current integration limits may overstate the employers' cost of providing social security benefits. The staff is directed to conduct further study as to whether lowering permissible social security offset limits would be more equitable in terms of considering the employers' relative contribution and as to the impact of such a change in terms of meeting retirement income goals.

In its final report, the Commission will recommend changes in this area so that coordination of social security and employee pensions is consistent with national retirement income goals.

CHAPTER V

RETIREMENT AGES

In May, the Commission tentatively endorsed a recommendation that the normal retirement age of 65 for social security should not be raised now out of recognition that there is a social contract with working people today who are approaching retirement age. However, there was general agreement that this normal retirement age should be raised in the future. The need for the increase is based mainly on improved longevity, demographic projections and the effect of these trends on the future financing costs of social security.

Other groups have come to similar conclusions and have endorsed a future normal retirement age of 68. The principal proposals that have been or are being considered for increasing the normal retirement age for social security are summarized in table 17. Early retirement age, now 62, would be raised in tandem.

The Commission believes that the age of normal retirement should change as average life expectancy in the population changes rather than being set at an age chosen arbitrarily. However, it appears that over time, implementing a formula to achieve such an outcome may be impracticable. An increase to age 68, as suggested by many groups, reflects increases in life expectancy since the beginning of social security and thus reflects changes that have already occurred in the proportion of adult life that is being spent in retirement, as shown in table 18. Therefore, because of the need to plan for the future, age 68 could be recommended now as the future normal retirement age. That age could be reevaluated in the future as life expectancies change.

The Commission concurs with the recommendations of the National Commission on Social Security and the American Council of Life Insurance noted in table 17. Their recommendations appear to meet the requirements of demographic changes and future financing needs discussed in the staff working paper Demographic Shifts and Projections: The Implications for Pension Systems. Under this proposal, the normal retirement age of 68 would be phased in over a 12-year period beginning

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Table 17

Summary of Proposals to
Increase Social Security Retirement Age

Organization	Date	Increase in Age	Starting Date	Closing Date	New Age
Advisory Council	1975	1/12 yr each 6 mos.	2005	2023	68
Advisory Council[1]	1979	2/12 yr each yr	2000	2018	68
National Commission[2]	1980	1/4 yr each yr	2000	2012	68
HR 9595 Conable	10/77	Schedule	Dec. 1999	Mar. 2011	68
HR 12468 Ketchum	4/78	Schedule	Dec. 1999	Mar. 2011	68
American Council of Life Ins.	10/80	1/4 yr each yr	2000	2012	68

[1] Should be seriously considered

[2] Tentative recommendation

Source: Summary prepared by the President's Commission on Pension Policy

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in the year 2000. The change would affect the baby boom cohort and following generations but age 65 would be retained as the normal retirement age for current middle-aged and older workers. The Commission recommends that this proposal for a future raising of the normal retirement age be adopted now to provide sufficient advance warning to the younger workers that there will be a gradual move upward.

The Commission recognizes that older workers approaching retirement age may have health and unemployment problems. Raising social security retirement ages affects the use of early retirement as a solution to these problems. The Commission will not ignore disability and unemployment problems and will address those problems as part of issues other than that of retirement ages in its final report.

TABLE XVIII

AVERAGE LIFE EXPECTANCIES

CENSUS DATA:

AGE	'39 - '41	'49 - 51	'59 - 61	'69 - 71	'77
18	50.34 yrs.	53.07 yrs.	54.46 yrs.	54.86 yrs.	56.8 yrs.
19	49.44	52.14	53.52	53.93	55.9
20	48.54	51.20	52.58	53.00	54.9
21	47.64	50.27	51.64	52.07	54.0
22	46.75	49.34	50.70	51.15	53.1
23	45.86	48.41	49.76	50.22	52.1
24	44.98	47.49	48.83	49.30	51.2
25	44.09	46.56	47.84	48.37	50.3

AGE	'39 - 41	'49 - 51	'59 - 61	'69 - 71	'77
64	13.27 yrs.	14.45 yrs.	15.03 yrs.	15.65 yrs.	16.9 yrs.
65	12.74	13.83	14.39	15.00	16.3
66	12.22	13.22	13.76	14.38	15.6
67	11.71	12.62	13.15	13.76	15.0
68	11.21	12.04	12.55	13.16	14.3
69	10.72	11.47	11.96	12.57	13.7
70	10.25	10.92	11.38	12.00	13.1

Sources:

1. U.S. Department of Commerce. Bureau of the Census. *U.S. Life Tables and Actuarial Tables* 16th Census 1940. Washington, D.C.: U.S. Government Printing Office, 1946.
2. U.S. Department of Health, Education, and Welfare. Public Health Service. *U.S. Life Tables for 1949-51.* Vital Statistics Special Report, Vol. 41. Washington, D.C.: U.S. Government Printing Office, November 1954.
3. U.S. Department of Health, Education, and Welfare. Public Health Service. *U.S. Life Tables, 1959-61.* Vol. 1, No. 9. Washington, D.C.: U.S. Government Printing Office, December 1964.
4. U.S. Department of Health, Education, and Welfare. Public Health Service. *U.S. Life Tables, 1969-71.* Vol. 1, No. 1. Washington, D.C.: U.S. Government Printing Office, May 1975.
5. U.S. Department of Health, Education and Welfare. Public Health Service. *U.S. Life Tables, 1977.* Preprint. Nol. 2, Section 5.

The Commission plans further study of the Social Security Disability Insurance Program (DI) and other disability programs. At this time, the Commission recommends that benefits under DI be available through the age at which normal retirement benfits are available under social security. Therefore, in conjunction with the recommended changes in social security retirement ages, the age through which DI is available would move upward from 65 to 68 over the 12-year period beginning in the year 2000. This would allow future workers with employment-related health problems to receive assistance from this program up to the normal retirement age.

The Commission wishes to encourage private sector labor markets and public employment and unemployment programs to address the problem of unemployment among older workers. Since the recommendation to change the normal and early retirement ages will not begin to take effect for 20 years, there should be sufficient time to explore solutions to the employment problems of older workers through programs other than social security.

Federal Civil Service Retirement

The cost of early retirement for public employees, particularly federal employees, is of serious concern to the Commission. The average age of retirement under programs covering federal workers is well below that of social security. An unreduced annuity at age 55 is available after 30 years of service. Under social security, no benefits are available until age 62 and full benefits are not available until normal retirement age.

Chart 8 illustrates the downward trend in retirement ages for federal civil service since 1966 when unreduced benefits were made available at age 55. Before that time, benefits were reduced 1 percent for each year below age 60. For all age and service retirees, the average retirement age declined by almost 4 years in the period between 1965 and 1968.

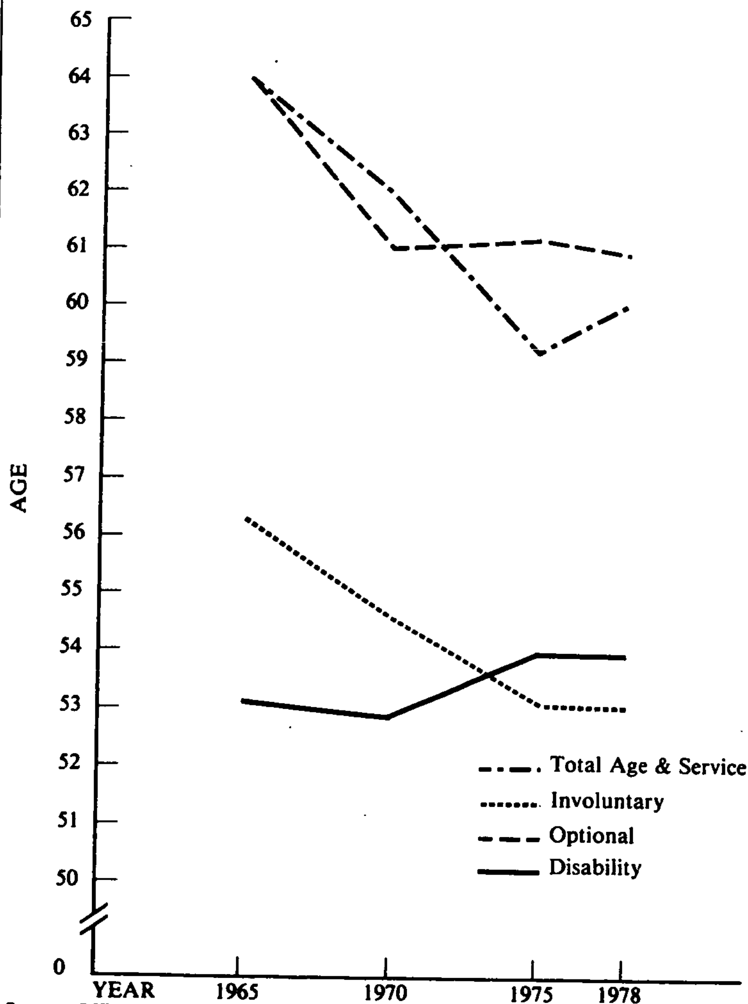
At an October 9, 1980, Commission hearing on early retirement, an official from the General Accounting Office testified:

> With the tremendous costs associated with federal retirement programs and the large unfunded liabilities that have accumulated, the continuation of generous early retirement benefits may just no longer be possible. Rather than encouraging people to retire early, we believe the Government's retirement policies should more appropriately be designed to encourage the retention of experienced personnel wherever possible.

The Commission recognizes the cost of unreduced retirement benefits at early ages and also expresses a desire that workers be encouraged to work longer. Therefore, a retirement age policy for federal civil service retirement programs that parallels that of social security is recommended. Under this recommendation, the normal retirement age of 65 would be phased-in for new retirees. Further study is needed on the implementation of such a phase-in. Early retirement benefits would be

CHART VIII

TRENDS IN THE AVERAGE AGE OF RETIREMENT, BY RETIREMENT PROVISION, FOR FEDERAL CIVIL SERVICE EMPLOYEES SELECTED YEARS, 1965 - 1978



Source: Office of Personnel Management Compensation Group.
Federal Fringe Benefit Facts, 1978. (Preliminary Report, 1979). Tables B-2 and B-12.

actuarially reduced for future federal workers entering retirement. These retirement ages would rise as social security retirement ages increase.

Private Pensions

Under private pension plans, normal retirement age is defined as the age when the employee may retire and receive a full benefit. Age 65 is used most often as the normal retirement age.

Under ERISA, plans are not permitted to delay benefit payments beyond age 65 unless a participant requests such a delay or the employee remains on the job past age 65.

The Commission considered the ERISA provision for the payment of normal retirement benefits by age 65 in conjunction with its recommendation to move the normal retirement age of social security to age 68. The Commission recommends that ERISA be amended to allow private pension plans, on a voluntary basis, to move up their normal retirement age when the social security retirement age is adjusted.

With regard to early retirement, it was agreed that management and unions should continue to determine early retirement provisions under private sector plans.

Very Early Retirement in Hazardous Occupations

Although mandatory retirement before age 70 is no longer legal, the law provides an exception from this rule for hazardous duty occupations. Mandatory retirement ages in hazardous duty occupations range from the early 40s to the early 60s. Variations in retirement ages in selected jurisdictions for police and firefighters are shown in table 19. Retirement ages for the military are shown in table 20.

Table 19

Average Age of Retirement for Police and Firefighters in Selected Jurisdictions, 1977

	Police	Fire
Los Angeles	48	53
Houston	59	54
Chicago	NA	58
New York State	49	NA

Source: President's Commission on Pension Policy, working paper Retirement ages given by Pension Board in each jurisdiction.

While mandatory retirement for these occupations is based on the assumption that physical capacity and thus job performance declines with age, there is no consensus concerning the critical age of decline. A study for the President's Commission on Military Compensation (PCMC) concluded, as have other studies, that "severe age deficits are not found until the sixth, seventh and eigth decades."16/

Table 20

Number and Percent of Military Personnel Retired During FY 1978 and Receiving Retired Pay as of September 30, 1978[1]

Age	Total Number	Total Percent	Non-Disability Number	Non-Disability Percent
Total	44227		38664	
16-19	339	.8	0	-
20-24	1976	4.5	0	-
25-29	954	2.2	0	-
30-34	587	1.3	7	-
35-39	11944	27.0	11316	29.3
40-44	17457	39.5	16826	43.5
45-59	8088	18.3	7778	20.1
50-54	2230	5.0	2120	5.5
55-59	592	1.3	568	1.5
60-65	58	.1	49	.1
65+	2	-	0	-

[1]Does not include individuals retiring from the reserve units who are entitled to benefits at age 60. (Title 3 Entitlements)

Source: DLA (Defense Manpower Data Center) Actuary Office, June 25, 1979.

16/BioTechnology, Inc. A Review of the "Youth and Vigor" Concept and Its Importance in Military Occupations. February 1978, p. 30.

There is also a good deal of controversy as to which occupations demand physical capacities possessed only by those who are young and vigorous. As the PCMC study states:

> There are specific elements within the armed forces where an excellent case can be made for the need for youthful and vigorous personnel, presumably having an average age in the twenties. For the most part, these will be units trained directly for combat. For other elements in the military, in the majority, occupational requirements are not significantly different from those found in comparable civilian positions. Here the need for youth and vigor is tenuous if it exists at all. The requirement for sound judgment, tempered through extensive experience, may be of much greater importance.

A Government Accounting Office representative also testified before the Commission in its October 1980 hearing on early retirement on the need for youth and vigor in the military as follows:

> ...DOD views youth and vigor as a universal requirement for all members regardless of occupational specialty or type of assignment. However, DOD has not defined what it means by youth and vigor. It does not know how old service members are when they are no longer young and vigorous or what occupations require youth and vigor.
>
> Combat-related jobs probably require younger personnel than other federal occupations. In noncombat jobs, however, the maturity, experience, and judgment gained through longer service are more valuable than physical stamina and agility.

There has been some concern that benefits awarded to individuals for reasons other than old age are administered as retirement benefits. The President's Commission on Military Compensation has proposed that military benefits be deferred until the employee reaches normal retirement age and that some form of compensation be awarded at the end of military employment to help in the transition to a second career. The New York State Pension Commission examined a similar proposal for police and firefighter retirement benefits in New York State.

The Commission is concerned over the issues raised by other investigative bodies and directs the staff to prepare a working paper on military and hazardous duty pensions. In addition, options on how to best reform these pension programs are to be prepared for presentation at the Commission's January meeting. In particular, the Commission is concerned over the receipt of pension benefits by relatively young workers in these occupations. The Commission believes that forms of compensation other than pensions may be more appropriate for such management goals as workforce recruiting and retention.

APPENDIX A

Preliminary Alternatives for MUPS Project

Participation Rules

(1) Age 45, 3 years of service, 1,000 hours of employment
(2) Age 30, 1 year of service, 1,000 hours of employment
(3) Age 25, 1 year of service, 1,000 hours of employment
(4) Age 20, 1 year of service, 1,000 hours of employment
(5) Age 25, 1 year of service, 500 hours of employment
(6) Social security eligibility criteria

Vesting Rules

(1) 10 years
(2) 5 years
(3) 3 years
(4) 1 year
(5) Full and immediate

Benefit Accrual Rate For Defined Benefit Alternatives

(1) ¼ percent per year
(2) ½ percent per year
(3) 1 percent per year

Indexing Rules

From time of separation to retirement age

(1) 100 percent of CPI, no cap
(2) 80 percent of CPI, no cap
(3) 80 percent of CPI, 5 percent cap
(4) 70 percent of CPI, 4 percent cap
(5) No Indexing

From time of retirement

(1) 100 percent of CPI, no cap
(2) 80 percent of CPI, no cap
(3) 80 percent of CPI, 5 percent cap
(4) 70 percent of CPI, 4 percent cap
(5) No Indexing

Contribution rate for defined contribution alternatives

(1) 1 percent of pay
(2) 3 percent of pay

Survivor Benefit Rules

(1) Death prior to retirement: 3/4 of vested benefit to be paid at surviving spouse's normal retirement age.

Death after retirement: 3/4 of annuity continued to survivor.

(2) Death prior to retirement: 2/3 of vested benefit to be paid immediately if spouse over age 50 at time of death; otherwise, 3/4 of vested benefit at normal retirement age.

Death after retirement: 3/4 of annuity continued to survivor.

Implementation Rules

(1) Only prospective service and contributions after date of implementation are used.

(2) For those over age 40 at time of implementation, five years of past service and contributions are credited in calculation of future benefits.

NOTE: These preliminary alternatives are subject to change as their effects on employer cost and benefit delivery are analyzed.

Appendix B

President's Commission on Pension Policy
736 Jackson Place, NW, Washington, DC 20006

November 18, 1980

President Jimmy Carter
The White House
Washington, D.C. 20500

Dear Mr. President:

As you know, on May 23, 1980 the President's Commission on Pension Policy issued its first interim report. Our initial report called for the development of a balanced program of social security, employee pensions and personal savings for retirement. The interim recommendations specifically called for an expanded role for employee pensions and new incentives to encourage increased retirement saving.

Today we are presenting our second interim report. Our final report will be completed by late February, 1981.

This second report reviews the Commission's progress in developing options for a minimum universal employee pension system and focuses specifically on possible reforms of the social security system. The Commission endorses the basic role of social security in providing some baseline benefits to nearly all older Americans. The program has been a remarkable achievement in social justice for the elderly. The Commission is committed to insuring that the fundamental income security elements of the program are preserved and maintained.

However, the social security system faces a number of long-term difficulties which could threaten its ability to deliver needed benefits after the turn of the century. Corrective action must be initiated in the near future. Present population trends indicate that the dependency ratio between active and retired workers will not be favorable for the pay-as-you-go social security system after the turn of the century. This is because of the future retirement of the "baby boom" generation. Foreseeing this development, and a corresponding increase in longevity, the Commission is tentatively recommending that the normal social security age be raised to 68 by the year 2012. We feel that the early social security retirement age should be raised in tandem.

Our report also suggests a number of policy options we have under study which would expand some social security benefits to the lowest wage earners. We are also assessing various alternatives to the current social security financing structure. However, we have explicitly rejected several options. And finally, the Commission feels that the rules concerning social security's coordination with employee pensions should be re-examined.

We are nearing completion of a series of research projects designed to give us detailed cost assessments of all our interim recommendations. The information will be incorporated into our ultimate recommendations. We are pleased to present the second interim report to you. I believe that our final report will provide the national policymakers with a detailed retirement income policy.

Sincerely,

C. Peter McColough
Chairman

President's Commission on Pension Policy
736 Jackson Place, NW, Washington, DC 20006

November 18, 1980

The Honorable Walter F. Mondale
President
United States Senate
Washington, D.C. 20515

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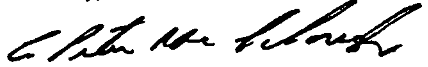

C. Peter McColough
Chairman

President's Commission on Pension Policy
736 Jackson Place, NW, Washington, DC 20006

November 18, 1980

The Honorable Thomas P. O'Neill, Jr.
Speaker of the House
U.S. House of Representatives
Washington, D.C. 20515

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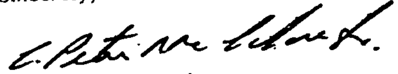

C. Peter McColough
Chairman

Appendix C

PRESIDENT'S COMMISSION ON PENSION POLICY

FACT SHEET

Background:

The Commission's areas of study and its mandate are incorporated in Executive Order 12071 signed by President Carter. In the Fall of 1978, C. Peter McColough, the Chairman of Xerox Corporation, was appointed by the President as Commission head. On February 14, 1979 the remaining 10 members of the Commission were appointed by the President and legislation (PL 96-14) authorizing a $2 million, two-year study of the nation's retirement income policies was submitted to the Congress for approval.

The Executive Order:

Executive Order 12071 mandated that the Commission study the nation's retirement, survivor and disability systems seeking advice from interested individuals and groups, private and public organizations, Congress, and federal government agencies. The Commission works closely with the agencies of the federal government that are directly involved with retirement income programs and various study groups sponsored by the government which are also looking at particular aspects of the retirement income system.

Among the areas being studied as a result of the Executive Order are:

- -- present overlaps and gaps among the private, state and local sectors in providing income to retired, surviving, and disabled persons;
- -- the financial ability of present private, federal, state and local retirement, survivor, and disability systems to meet their future obligations;
- -- appropriate retirement ages, the relationship of the annuity levels to past earnings and contributions, and the role of current retirement, survivor, and disability programs in private capital formation and economic growth;
- -- the implications of the recommended national policies for the financing and benefit structures of the retirement, survivor, and disability programs in the public and private sectors; and
- -- specific reforms and organizational changes in the present systems that may be required to meet the goals of national pension policies.

The Executive Order requires that the Commission issue a series of interim and final reports during its lifespan.

71-536 0 - 81 - 7

Retirement Income Systems in the United States:

About 50 percent of the American workforce is covered by a public or private retirement income plan but no comprehensive, coordinated national retirement income policy exists.

In addition to the basic Social Security program (OASDI) which covers nearly all private sector employees and most state and local government employees, there is the Civil Service Retirement System which covers the vast majority of federal employees, dozens of separate plans covering special groups of federal civilian employees, a separate pension system for military personnel, thousands of separate plans covering various groups of state and local government employees, and hundreds of thousands of separate plans established by private sector employers.

Because these thousands of separate plans developed in response to different needs and different requirements, they do not necessarily fit together in ways that provide an adequate and equitable retirement system. Some workers may qualify for pensions under several different plans during their career, while others may reach retirement with only their OASDI benefits. Consequently, some workers will enjoy a financially secure retirement while others will exist near the poverty line.

It is one of the assignments of the Commission to map out the framework for a national retirement income policy and to suggest changes in the present system.

The Demographics of Aging:

The importance of retirement income programs will increase in the coming years as the population grows older, women become even more of a factor in the workforce, people live longer, and retirement trends change.

Today, one out of nine Americans is over age 65. Older Americans totaled 23.5 million people in mid-1977, about 11 percent of the population. And, although the proportion of persons 65 and older in the population is not expected to increase dramatically through the year 2000, the so-called "baby boom" population will start to retire in 2010. By the year 2035, persons 65 or older are expected to represent 22 percent of the population.

Retirement Systems and Capital Formation:

Approximately one-half million private pension plans, 6,600 state/local government pension plans, and some of the 38 federal worker retirement plans collectively hold over $550 billion in assets. And, the two-and-a-half million Individual Retirement Accounts have accumulated another $2.5 billion in capital.

One of the most difficult issues impeding the development of a coherent national retirement income policy is the role of various retirement systems in capital formation and economic growth. Together, various pension plans hold 20 percent of all corporate securities in the United States. So, changes in different plans, or changes in the way these plans invest their capital or are funded, would have a significant impact on capital formation.

Finally, OASDI, the military retirement programs, and most federal civilian retirement plans are partially or entirely funded on a "pay-as-you-go" basis which transfers billions of dollars in capital from one generation to the next. Any changes in this system of funding could also have a profound effect on capital formation.

Other Study Groups:

The Commission is working closely with other groups surveying particular aspects of the national retirement income system so that duplication of effort can be avoided. The data accumulated will be available to the Commission for its own uses. Some of the groups whose research will be helpful to the Commission are:

-- The Advisory Council on Social Security

-- The National Commission on Social Security

-- The Universal Social Security Coverage Group

-- The President's Commission on Military Compensation

-- Studies of state/local government plans by H.U.D. and the House Pension Task Force

-- A report on private plan investment patterns by the Department of Labor

-- Sections of the report by the U.S. Department of Justice/H.E.W. study group looking into sex discrimination

In addition, the G.A.O. and the Congressional Budget Office have issued a number of reports dealing with pension issues.

The Commission's Proposed Research Agenda:

In order to conform with Executive Order 12071, the Commission decided at its first meeting to divide Commission resources into three separate study groups of its own:

-- Study Group 1: Present and Future Needs of Retired Population

-- Study Group 2: Ability of Systems to Meet Income Needs

-- Study Group 3: Tax Policy, Capital Formation and Economic Growth

Additional Commission Study

In addition to the staff studies and the issues outlined in its May 23, 1980 interim report, the Commission will address the following topics in later reports: portability and vesting; the role of savings and assets in retirement income; the state and local sector and PERISA; social security financing; social security benefit structure; overlaps in pension plans; pension plans and collective bargaining; the federal employee retirement systems; actuarial and accounting standards; the effect of demographic shifts on savings; pensions and personnel management policy; the trade-

off between pensions and wages; the macroeconomic effects of savings on investment, capital formation and productivity; the costs to the individual and to the nation of providing adequate retirement income; the retirement income distribution; the effect of in-kind benefits on the income of the retired, and the organization of the executive and congressional branches of government to deal with retirement systems.

Most of these issues will also be included in the Commission's final report in February, 1981.

Appendix D

COMMISSION BIOGRAPHIES

C. PETER McCOLOUGH (Chairman) - Mr. McCologh is chairman and chief executive officer of Xerox Corporation. He is a member of the Steering Committee of the National Committee for Full Employment.

HENRY L. BOWDEN - Mr. Bowden is a partner in the law firm of Lokey and Bowden of Atlanta, Georgia. He is the former City Attorney for Atlanta.

JOHN BRAGG - Mr. Bragg is a member of the Tennessee House of Representatives. He is a member of the Council of Pensions and Retirement. Mr. Bragg is the former chairman of the National Conference of State Legislatures' Task Force on Public Pensions.

LISLE C. CARTER, JR. - Mr. Carter is president of the University of the District of Columbia. He was previously director of the Public Policy and Administration Program in the Graduate School of Business and Public Administration at Cornell University, and has served as an assistant secretary of the Department of Health, Education and Welfare, and as assistant director of the U.S. Office of Equal Opportunity.

JAMES CLARK, JR. - Mr. Clark is a member of the Maryland Senate where he is chairman of the Pension Study Committee, which completed a two-year study of the Maryland public pension systems in 1978. He is also a member of the National Conference of State Legislatures' Task Force on Public Pensions.

PAUL R. DEAN - Mr. Dean is professor of law and former dean of the Georgetown University Law School, and an expert in federal income, estate and gift taxation and estate planning. Mr. Dean also serves as neutral trustee for the Health and Retirement Funds of the United Mine Workers of America.

WILLIAM C. GREENOUGH - Mr. Greenough is trustee and chairman, CREF, Finance Committee, New York City.

MARTHA W. GRIFFITHS - Ms. Griffiths practices law in Romeo, Michigan. She represented the 17th Congressional District of the State of Michigan in Congress from 1955 through 1975, and sponsored the Equal Rights Amendment to the Constitution.

HARVEY KAPNICK - Mr. Kapnick is the former deputy chairman of the First National Bank of Chicago. Prior to that position, he was chairman and chief executive officer of Arthur Andersen and Company of Chicago.

JOHN H. LYONS - Mr. Lyons is the president of the International Association of Bridge, Structural and Ornamental Iron Workers. He is also vice-president of the AFL-CIO's Building and Construction Trades Department.

ITEM 2. THE PROGRESS OF THE ELDERLY IN THE AMERICAN ECONOMY, SUBMITTED BY MARTIN DUFFY,[1] VICE PRESIDENT, DATA RESOURCES, INC., LEXINGTON, MASS.

PURPOSE

This testimony is directed at providing a reasoned, empirical overview into the major economic dimensions affecting the elderly in the United States. My analysis is retrospective, covering the past 10 to 15 years, and prospective, covering the next 10 to 25 years. It is intended to provide some insight into:

(1) How the elderly have fared during the preceding decade.

(2) How the elderly are likely to fare in the next decade.

(3) The major influences impacting the aged and how these shape their future.

This testimony results from recent research on the effects of inflation on the elderly and on their prospects in the future economy. To clarify, the elderly are defined as those persons aged 65 or more. For analysis, this group is divided between those aged 65–71 and 72 and over. I have also investigated the near elderly, those aged 55 through 61 and 62 through 64, to note particular differences or tendencies which adumbrate future change in the economic status of the elderly. Where useful, the results for the near elderly are included.

MAJOR CONCLUSIONS

In the decade of the 1970's, there have been discernible economic gains and losses for the elderly: In income, in expenditures, and in net worth.

In income, there has been marked improvement in their real and relative income, particularly since 1967. Since that time, real income for elderly families and persons has grown by about 2.5 percent per year. Income gains for the elderly exceeded those of younger Americans. Their relative income, expressed in relation to that of the nonelderly, improved substantially during the 1970's. The influence of the dramatic changes in social security is apparent in terms of the economics of the benefiting households (see figure I–1).

In expenditures, the elderly are somewhat worse off than the nonelderly in responding to the particular kind of inflation that we've experienced since 1967. Their cost of living is tied to a market basket, dominated by necessities, that has escalated more forcefully than that of younger households. Elderly purchases are more concentrated in such necessities as food consumed at home, fuel and utilities, and health. And, the older the household, the greater the importance of these necessities in their total expenditures. In the 1970's, the overall CPI increased at an annual rate of 7.2 percent a year while food, fuel, and medical advanced at 8.4 percent per year (see table I–2).

As a result, the cost of living for elderly families and persons increased somewhat faster than the cost of living for younger consumers. The elderly's loss from rising prices was not as dramatic as their gains from rising incomes, leaving them better off in the dual measure of income and expenditure.

However, the wealth of the aged, often conceived of as their retirement savings, lost out during the 1970's. The unanticipated inflation of the past 10 to 15 years has acted to eviscerate wealth and to reward aggressive debt behavior. Unlike younger persons, there is little offsetting debt in the portfolios of the aged to compensate for asset losses. Their absolute and relative loss exceeds that of other age groups. Within the aged, those elderly with a greater concentration of their assets in financial instruments and with little or no home ownership or debt, were particularly hard hit during the 1970's. Because the savers lost out relative to the debtors, the wealth distribution both for elderly and for the nonelderly has become more equitable.

As households are net creditors and government is a net debtor, inflation and the progressive income tax have acted to transfer wealth from private to public control. On the plus side, social security as a form of wealth compensated the elderly in part for their losses in private wealth. A major consequence of inflation and this transfer is that elderly Americans who had saved for their retirement found themselves increasingly more dependent on public support rather than on their own resources.

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[1] See statement, page 82.

IN PROSPECT, OVER THE NEXT DECADE

Elderly income gains, particularly in relation to the income prospects of the nonelderly, will be significantly less than those of the 1970's. A relative decline in their income fortunes will begin shortly. This forecast assumes policies and behavior as these are. The forecast for relative decline arises from the maturation of social security as a system, the reduced prospects for overall growth in the economy during the 1980's, declining labor force participation rates among the near elderly and elderly, competing Federal priorities, particularly defense, and public's resistance to tax increases. In combination, these will act to restrict rather than expand the prospects for advances in elderly incomes. In contrast, gradual increases in private pension coverage and benefit levels and greater retirement savings will assist new retirees. But current retirees are without these options. The net effect is to impair the income prospects of the elderly. Higher gains are anticipated for younger Americans.

In expenditures, the elderly's cost of living, primarily led by escalating energy, food, and health costs, is forecast to exceed that of younger Americans. As in the 1970's, the difference is discernible but not overwhelming. But with elderly incomes advancing much more slowly, the price disadvantage will be more keenly felt by the elderly.

Forecasts of future wealth gains and losses depend on the responsiveness of capital markets and other investments to various factors among which is inflation. In a very basic way, increases in the future rate of inflation will favor debtors over creditors. In comparison with others, the elderly are more risk-averse and net creditors. In the 1970's, they were particularly hurt on the asset/debt account by the unanticipated rise of inflation and the response of financial markets to this increase. In addition, higher taxes on the lower real, but higher inflated, earnings also reduced the net real return to these investments. The elderly typically invest with return rather than appreciation in mind. The elderly are much more dependent on asset income than the nonelderly and much less able to recoup losses as these occur. Therefore, future gains to savers are particularly important to the elderly even outside of gains and losses to pension and other retirement funds.

Finally, this report confirms that the elderly are not inflation-proof, but, on the contrary, have demonstrable gains and losses in their income, expenditure, and wealth accounts. Their prospects over the next decade are less auspicious than those of the past, even with a continuation of public policies as they are.

INTRODUCTION

This study was prepared as an economic inquiry into elderly, their recent history and forecast, with particular emphasis on the effects of inflation. The reason for such an analysis is obvious, i.e., the emergence since 1965 of substantial and persistent price inflation without knowledge as to its effects on the wealth, income and expenditure patterns of the elderly. Without studied opinion, conjecture and uninformed consensus substitute for reasoned judgment. The result is public opinion and public policy guided by false assumptions.

Traditionally, the assumption has been that inflation is damaging to the elderly. However, beginning in 1965, the reforms in social security, particularly automatic indexing, and the extension of in-kind benefits, medicare and food stamps, have operated to benefit the income of the elderly in general and in relation to that of the nonelderly. Income for elderly families, defined as those aged 65 and older, advanced at an average rate of about 2.5 percent per year since 1967. Income for younger families and persons advanced less quickly so that the elderly made significant relative income gains during this time. With these gains, which primarily arose from social security, the elderly were able to recoup postwar period much of their loss in relative income.

Although elderly incomes, particularly from social welfare programs, have risen, so also have their expenditures. For the elderly, the prevalence of home ownership means that the fuel and property tax increases of recent years are worrisome and, in certain cases, burdensome. Since 1969, the costs of home ownership have increased more rapidly than the cost of renting. And, for those elderly who may have sold their homes before or during this period, the erosion of their resultant assets has been substantial in many cases. Whereas the CPI rose at an annual rate of 6.1 percent from 1968 to 1978, the value of common

stocks rose only 2.8 percent. At a compound rate this results in a cumulative loss of about 30 percent in the real value of wealth held in stocks over the period.

Another hidden cost to the elderly during this period has been in reduced employment opportunities due to high rates of economy-wide unemployment, particularly in the recessions of 1969–70 and 1974–75. In addition, the rise of social insurance for the aged has contributed to a diminution in earnings opportunities for the aging worker. The spread of social security over a greater percentage of the work force ensures that the earnings test has more universal application. The legislative approval for reduced benefits from social security at age 62 induced employers to introduce industrial retirement and preretirement schemes conditioned to this younger age. The allure of benefits has induced earlier retirement while subsequent inflation has diminished the prospects for retirement comfort. In a 1979 poll conducted by Lou Harris on retirement, 51 percent of recent retirees stated that they would prefer to be working and earning a salary. The rise of social insurance schemes has led to certain perverse income and employment effects for the elderly.

Finally, the cost of living for the aged has risen somewhat faster than the general Consumer Price Index. Since 1970, the annual CPI has increased 7.2 percent. Certain necessities—food at home (8.3 percent), fuel and utilities (9.3 percent), and medical care (7.9 percent)—which comprise a relatively greater percentage of the elderly's market basket, have exceeded the composite rate. An analysis of consumer expenditures shows that the particular kind of inflation that the United States has experienced over the past decade has resulted in (1) even higher costs for the elderly, and (2) that the oldest (i.e., those persons aged 72 and older) bear the worst brunt of these increases. Inflated incomes from higher public transfer payments have mitigated these cost-of-living increases for many of the aged over this decade but these gains are being reversed in the current period of high inflation. Automatic indexing of social security payments at the CPI and with a lag (based on price increases over the past year) barely compensates the elderly for the full amount of their particular cost-of-living increase. Other sources of elderly income, particularly from assets and private pensions, are not keeping pace. Therefore, the elderly are vulnerable to inflation, particularly as they age.

What follows is a summary report on inflation and the elderly. The gist of this analysis is that the history of past gains differs from that of the present perspective. Over the decade 1967–76, elderly incomes gained, vis-a-vis inflation and vis-a-vis the income of the younger persons, the retirement savings of the elderly decapitalized (an effect most pronounced for the most wealthy), and that prices faced by elderly consumers rose somewhat faster than prices in general. Since 1967, the income position of the elderly has improved both absolutely and relative to the rest of the population. Unfortunately, we forecast for this trend of improvement to reverse in the near future. The outlook is for an imminent decline in the relative share of income going to the elderly. This assumes that Federal policies remain as they are. Real incomes of the elderly will rise but at a slower rate than the past and at a slower rate than that of younger families and persons. As such, the elderly will receive a diminishing share of society's resources. The demographics of the aged group contribute to this relative decline. The number of low income old-old (aged 75 and over) will grow relatively faster than the young-old over the next decade. Outside of demographic change, income erosion will occur because the income of the elderly is not inflation-proof. For retirees, private pension income has consistently been indexed less than rising prices. Post losses in capital markets reduced for many elderly households the real value of savings. The prospect for gains, rather than losses to savers, is clouded by the immediate perception of loss over the past 10 to 15 years. As for wages, future increases for the younger working population are forecast to be more positive responding to gains in productivity and inflation.

MAJOR FINDINGS

Income: The incomes of elderly persons have grown rapidly since 1967, thanks mainly to improvements in social security, extensions of private pensions, and the general rise of retirement savings in the long period of prosperity following World War II. In the recent period, 1967 through 1976, real incomes for the elderly have increased and inflation has been a force toward somewhat greater equality in the distribution of these incomes. Even with these improvements,

fully one-half of all elderly consumers had a 1976 income of less than $100 a week. Despite relative gains, the average income of the elderly is still only a fraction of that of the nonelderly. In 1976, the average income of those 72 and over was only 46 percent of that of the near elderly, aged 55–61. Because of the advent of early retirement, ages 55–61 are chosen as the initial study group for what we call the "elderly." Three other elderly age groups are also analyzed, i.e., 62–64, 65–71, and 72 and above, both for families and singles.

In the period 1967 through 1976, increases in social security benefits more than compensated elderly incomes for gains in prices. Real incomes rose while coverage was extended. The step adjustments, increasing nominal benefits by about 70 percent from 1968–71, were legislated to boost the sagging income position of the elderly. Automatic benefit indexing, based on the CPI, was legislated by Congress in 1972. The recurrent step adjustments, characteristic of the past, have ceased. With automatic indexing, social security contributed to a further improvement in both the absolute and relative income position of the elderly. The adopted social security formula overcompensated for the bite of inflation through a technical inadvertence dubbed "double indexing." This feature threatened massive fund deficits and was eliminated by Congress in 1978. Single indexing, the original intent of the 1972 Congress, was accomplished in 1979. And, with single indexing, the rapid expansion in the real level of social security benefits which occurred during 1967–78 is past. These gains are not apt to be repeated.

"The Commissioner of Social Security declared today that a long era of 'expansion of social security programs' and rising benefits had ended and that the 1980's must be 'a decade of reform' in which Congress mandates 'painful adjustments'."—New York Times, July 16, 1979.

In the past decade, the elderly improved on their relative economic position in society. Figure I–1 presents this history, comparing the mean income of consumer units aged 65 and over versus the mean income of those consumer units under age 65. This display illustrates the relative loss of economic status of older Americans from 1950 through 1965, occasioned mainly by their declining labor force participation and by a reduction in real per capita benefits available under social security in that period. Reforms in social security, beginning in 1965, were the primary spur in reversing this decline. Income gains were greatest in the 1968–71 period as an outgrowth of the Federal Government's war on poverty. From 1967–76 the real per capita income of the elderly rose by just over 2 percent a year. Most of this growth occurred in the earlier part of that decade.

Even though elderly incomes have continued to rise, the relative income gains of the elderly are now more in question. Figure I–2 displays a forecast of the relative economic status of those consumer units aged 65 and over versus those below as measured by a comparison of mean incomes. This forecast is based on the DRI's long-term macroeconomic model and the Consumer Research Division's demographic economic model.

Although real income growth in the period 1973 through 1976 averaged only about 1 percent a year for those aged 62 and over, the 1974–75 recession principally affected the real incomes of younger consumers, resulting in relative income gains for older persons. The growth in the economy from this recession—the unprecedented expansion of employment, particularly more women in the labor force and the improvement in wage and salary incomes—have primarily benefited the nonelderly. Labor force participation of men aged 55–64 continued to decline. Without a reversal of this pattern, real incomes for the elderly will grow but at rates below that of younger persons. 1981 will usher in a new era of relative declining in fortune for the elderly. Table I–1 displays both history and forecast for various near elderly and elderly age groups.

FIGURE I-1

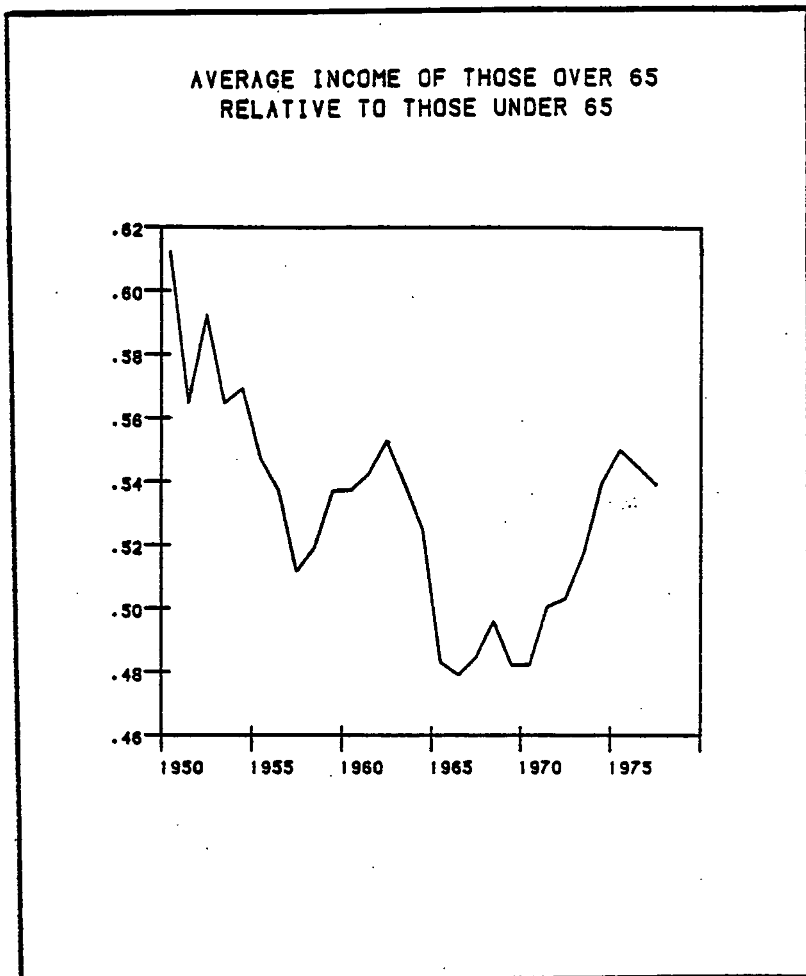
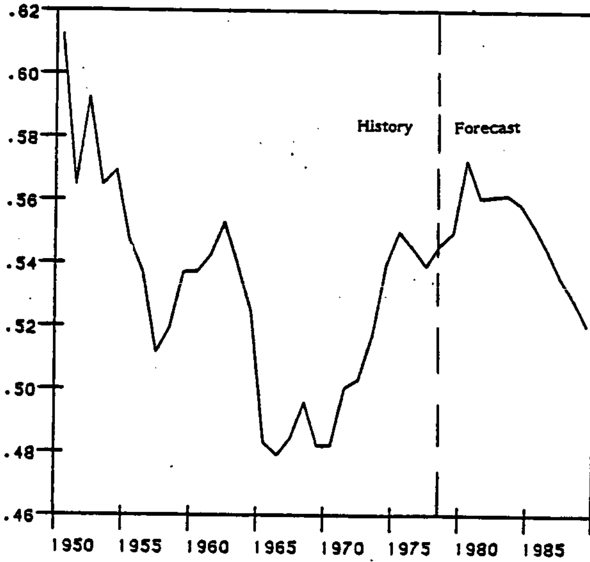


FIGURE I-2



The forecast presented in figure I–2 relies primarily on three factors: (1) Differential rates of growth in real income between the elderly and the nonelderly by age group, (2) changing demographic composition both for the nonelderly and the elderly, and (3) differences in income by age. The growth rates in real income by age of consumer unit as presented in table I–1 account, through the demographic economic model, for all of these movements.

This table illustrates the relative vulnerability of the near-elderly and younger consumer units to recession. Since 1977, it also reveals the slowdown in real rates of income growth for the most elderly. During the period 1973–76, real income declined by 0.6 percent a year for those aged 55–61 while the eldest group, those aged 72 and over, was advancing by 2.1 percent a year. Significant social security gains were achieved while the economy was in recession. The recovery, beginning in 1976, favored nonelderly income growth while the rates of growth of elderly incomes were slowing. Over the forecast period, 1979–90, the growth rate of elderly income will remain below the rates experienced in the ebullient period, 1967 through 1976, and below the anticipated gains for younger persons. For the eldest group, 72 and over, income growth over the period 1977 through 1990 is forecast to be about half that of the rate enjoyed during the decade 1967–76. The elderly have achieved substantial income growth in the past decade but will experience more limited gains in the future.

Future income of the elderly will grow due to several factors, including: (1) The wage indexing of benefits in determining the primary insurance amount, (2) the continued, although at a slowing rate, rise of private pension programs, and (3) the expansion of other savings alternatives such as individual retirement accounts. Furthermore, group income for the elderly will rise as new waves of younger, higher income elderly replace older, lower income elderly. With a continued growth in real incomes in the younger generations, these elderly of the future bring higher incomes and greater resources into retirement.

TABLE I–1.—ANNUAL PER CONSUMER UNIT REAL INCOME GROWTH

[Figures in percent]

Age group	History 1967–72	History 1973–76	Forecast 1977–79	Forecast 1980–85	Forecast 1986–90
Under 55	1.9	−1.4	1.6	1.1	2.0
55 to 61	3.3	−.6	2.3	1.7	2.3
62 to 64	3.2	.2	1.7	1.3	2.0
65 to 71	3.1	−.7	.7	.6	.8
72 and over	3.8	2.1	.8	.8	.8

Over the past decade, real per capita incomes have grown and income has come to be more equally distributed among the aged. The income of the poorest elderly has grown much faster than that of high-income elderly. The changing income distribution arises from inflation which has led to a reduction in the real worth of financial assets and pension wealth (and thereby hurting the upper income groups) and contributed to the general increase and indexation of social security benefits, primarily benefiting the lower income elderly. Further movements toward such policies as the half taxation of social security benefits will contribute to even greater equality in the distribution of elderly incomes. This type of policy is suggestive of the most likely way by which elderly incomes will become even more equally distributed; that is, by lowering the real incomes of those in the upper tail of distribution.

In the future, income gains for the elderly will rely more on such factors as: (1) A restoration of higher real returns from financial savings, (2) reverse actuarial mortgages to secure current income from the prevalent asset of the elderly, i.e., housing, and (3) greater labor force participation by the elderly. Without such changes, the elderly will be constrained to lower real income growth and to a reduction in their societal income share.

Expenditures: Since 1970, the cost of living for the elderly has risen faster than has the cost of living of for younger consumers. The major reasons for this disparity are:

—Expenditure patterns differ between the elderly and nonelderly with elderly consumers' expenditures concentrated more on core necessities such as medical care, fuel and utilities, and food at home.

—Rates of specific inflation (item-by-item price increases) differ over time; since 1970 some of the most rapid increases have been in medical care, fuel and utilities, and food. These have risen at a composite rate of about 8.4 percent a year versus a CPI increase since 1970 of 7.2 percent a year.
—As a consequence, elderly consumers have seen the price of the particular bundle of goods and services they consume rise somewhat faster than the price of that bundle purchased by younger consumers.
—The older the elderly consumer, the greater has been the adverse effect of recent inflation on the elderly's cost of living.

Purchase rates (the percentage of income spent on that expenditure category) and average incomes by age are presented in table I–2 together with category-specific rates of inflation and age-specific cost-of-living indexes (combining budget shares with category-specific inflation rates). Purchase rates clearly differ by age. Older consumers generally spend more of their income on food, fuel and utilities, and medical care than younger consumers while spending less on shelter, clothing, transportation, and entertainment.

These differences arise from differences in needs, reactions to prices, and income. Except for elderly families headed by a person under age 61, average family income is considerbly less for the elderly than for those under 55, leading to a concentration of expenditures on necessity items. Medical problems associated with age cause high purchase rates for medical care (particularly for those aged 72 and above) and also for fuel and utilities. The three categories that are relatively overrepresented in the budgets of the elderly—health care, fuel and utilities, and food—have experienced rapid rates of inflation in the seventies. In contrast to the conventional wisdom, the health costs of the elderly are not all met through medicare. Less than 40 percent of the personal health care of the aged were paid by medicare in 1974. Prof. Robert Clark of North Carolina State University notes that "limits of medical coverage suggest that chronically ill aged persons may be forced to exhaust their life savings for retirement in order to attain adequate medical care." [1] In 1972–73, the out-of-pocket health costs to the aged about equalled that of the nonelderly, but indexed to total expenditures, their direct health costs to all expenditures consume 73 percent more than those of younger households.[2]

TABLE I-2.—INCOMES, PURCHASE RATES, AND EFFECTIVE INFLATION RATES BY AGE

Expenditure category	Inflation between 1970 and 1979	Under 55	55 to 61	62 to 64	65 to 71	72 and over
Food at home (percent)	104.6	14.0	15.2	17.3	20.6	22.5
Health (percent)	98.6	4.3	6.0	8.2	8.9	11.0
Fuel and utilities (percent)	123.4	4.6	5.2	6.2	7.8	8.7
Transportation (percent)	88.5	18.2	15.0	16.4	16.3	12.9
Shelter (percent)	92.5	16.1	10.8	12.1	15.6	18.4
Clothing (percent)	43.5	5.9	4.3	4.5	4.7	4.3
Nonnecessities (percent)	77.1	23.8	19.7	20.9	22.8	21.7
1973 mean pretax income (1976 dollars)		$16,332	$16,972	$13,569	$9,950	$7,134
Inflation between 1970 to 1979 (percent)		87.9	89.8	90.4	91.3	92.4

In table I–2, the last row combines the budget shares with their respective category price indexes to create CPI's for the under-55 population and for each of the elderly age groups in this study. As expected, the concentration of elderly families' expenditures in categories with the highest inflation rates leads to greater overall increases in their constructed CPI's. In absolute terms, the index of inflation, adjusted for income, sex, and family status changes, grew from 100 (1970 base) to 192.4, (1979) for the 72's and over versus 187.9 for the under 55's.

Based on an analysis of the consumer expenditure survey, the elderly have experienced somewhat greater-than-average inflation during this period due to the concentration of their expenditures in the higher inflation categories—food, fuel and utilities, and medical care. Further, the adverse effects of recent price

[1] As quoted in Business Week, May 22, 1978, pp. 148–150.
[2] Brotman, Herman. "The Graying of Every Tenth or Every Ninth American," Special Committee on Aging, U.S. Senate, 1978.

increases rise with age among the elderly. Therefore, separate monitoring of the inflation rates faced by the elderly may be warranted, particularly in relation to any income indexing schemes relative to cost of living. The new quarterly surveys of the Bureau of Labor Statistics will allow for updating the CPI measure on a more current basis. The first of these quarterly reports from data collected in 1979 is scheduled to be released in 1981.

Wealth: Lord Keynes in his paper following World War I on the "Economic Consequences of the Peace" observed that: "By a continuing process of inflation, governments can confiscate secretly and unobserved an important part of the wealth of their citizens. There is no subtler, no surer means of overthrowing the existing basis of society than to debauch the currency."

The savings of the elderly have been adversely impacted by the largely unanticipated inflation of this period. With their relatively small savings and even lower debt, the aged are net creditors. Inflation has acted to redistribute wealth from creditors to debtors. Bach and Stephenson (1974) emphasize the exposure of the elderly to inflation on the asset/debt account. "Among households, inflation transfers purchasing power from older to young people and, contrary to the conventional wisdom, apparently from the very poor and the very rich to the middle- and upper-middle-income groups." The debt of the middle-income groups acts as their protection against inflation.

The wealthy elderly have been particularly hard hit by the recent inflation. A high proportion of their savings is in fixed-value instruments and in stocks wherein the total return to many investors since 1967 has averaged below the CPI. In a recent study, Joseph Minarick (1978) suggests that "inflation reduces most of the real income of the rich" and that low-income households fare well, except low-income elderly. Wolff's (1979) simulation analysis confirms this result.

Those elderly without appreciating assets, with little or no debt, and with a commitment to monetary assets, have been severely affected by inflation. This means that the elderly who rent have little or no debt and only such assets as stocks, bonds, and bank savings, and have lost considerable purchasing power from their portfolios since the late 1960's. A typical scenario for certain elderly households is to save for retirement; at retirement to convert these savings to "secure" forms as "money in the bank or corporate bonds," sell their homes to clear themselves of any mortgage debt, to gain additional liquid resources, and to avoid escalating homeownership costs; and then to rent. A retiree of 10 years ago, following this prescription, would have been impacted severely by our recent inflation. In 1968, the average new corporate bond yield was 6.5 percent. The CPI since 1968 has averaged just above 7 percent. Income has not kept pace with inflation and these 1968 bonds have suffered price declines. Bank interest for the small saver has been even less than bond yields, averaging about 5.3 percent over the last 10 years.

Home equity is a major form of savings for the aged. Although home equity represents only about one-third of the aggregate value of assets held by families 65 years of age and older, this statistic understates its importance to the average elderly household. The typical older family holds only minor other-than-home savings. In 1968, over 60 percent of persons aged 58 to 63 owned homes. The overall gains to the elderly from the appreciation of this asset have been substantial. In the period 1968 through 1978, the value of a single family home grew at 9.2 percent a year while the CPI averaged 6.1 percent. But these housing gains are only realized through sale while the costs of homeownership, particularly fuel and utilities, property insurance, and property taxes, are more immediate. A regional analysis of homeownership costs underscores this problem. For example, according to the Advisory Commission on Intergovernmental Relations 1972 Report on the property tax: "When compared to the property tax burden borne by the average family, the property taxload carried by elderly householders appears so heavy as to constitute a national scandal."

It goes on to state that in particular regions, as the Northeast, low-income elderly homeowners paid almost 30 percent of their income in property taxes. Similarly, the recent abrupt rise in fuel oil prices, common to the home heating systems in the Northeast, is not adequately represented in the overall statistics on the cost of homeownership. Even without considering these examples of regional impacts and other special cases, the average cost of homeownership has risen at a rate faster than that of the CPI.

With the rise in the costs of other necessities, the costs of homeownership impose a continuing burden on many elderly persons. Conversion of this appreciating home asset into more liquid savings can now only occur through sale as there exists no capital market for reverse annuity mortgages. Furthermore, in the recent past, financial savings have been eroded through progressive taxes and inflation. Most consumers, young and old, recognize this and aver the non-homeownership choice. Implicit rent is not taxed while financial earnings are. Therefore, the high homeownership costs remain and become more burdensome with age and declining income.

With most of their other assets, the elderly are familiar with financial loss. Marilyn Moon of the University of Wisconsin points out that the elderly "are not very sophisticated savers—their savings tend to take the form of bank accounts and securities that are very vulnerable to the impact of inflation."[3] In a later report entitled "The Death of Equities," Business Week, goes on to state that "while the number of (stock) investors under 65 dropped by about 25 percent from 1970 to 1975, the number of investors over 65 jumped by more than 30 percent. Only the elderly who have not understood the changes in the Nation's financial markets, or who are unable to adjust to them, are sticking with stocks."[4]

The individual wealth held in private pensions by retirees is, in general, nonindexed. A 1970 retiree with such a nonindexed pension now is receiving a real income at only about one-half of the 1970 rate. Many private pension plans have made occasional adjustments, but the net increase for all plans is far below CPI increases. The Bankers Trust study of private pension plans cited an average benefit increase of 16 percent in the period 1969–75 versus a CPI increase of 47 percent. Thompson's analysis (1978) of recent retirees confirms this benefit decline. A full indexing of private pension plans is considered to be prohibitively expensive, particularly as the real wealth of pension plans which are invested in capital markets has been diminished by this inflation.

Because the elderly are net creditors in an economy where debtors have been rewarded, there have been substantial losses in their overall portfolios. These losses are concentrated, as wealth is concentrated, in the upper part of the aged-wealth distribution. Losses from erosion of the value of private pension benefits are concentrated among those elderly in the middle and upper end of the income distribution. Financial wealth—stocks, bonds, annuities, and the like—is heavily concentrated in the topmost tail of this distribution. Debts are minor for the elderly, particularly in the middle and upper end of the distribution. Homeownership is more evenly distributed and the aged who own little more than their own home have been relatively well served on the asset account by the escalation of home prices.

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[3] As quoted in "Business Week, May 22, 1978, p. 150.
[4] From "Business Week," May 13, 1979, pp. 54–55.