FUTURE DIRECTIONS IN SOCIAL SECURITY

HEARING

BEFORE THE

SPECIAL COMMITTEE ON AGING

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

FIRST SESSION

PART 9—WASHINGTON, D.C.

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Future Directions in Social Security:
Part 1. Washington, D.C., January 15, 1973.
Part 2. Washington, D.C., January 22, 1973.
Part 3. Washington, D.C., January 23, 1973.
Part 4. Washington, D.C., July 25, 1973.
Part 5. Washington, D.C., July 26, 1973.
Part 6. Twin Falls, Idaho, May 16, 1974.
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FUTURE DIRECTIONS IN SOCIAL SECURITY

TUESDAY, MARCH 18, 1975

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

The committee met, pursuant to notice, at 10 a.m., in room 3302, Dirksen Building, Hon. Frank Church, chairman, presiding.

Present: Senators Church, Moss, Fong, Percy, and Clark.

Also present: William E. Oriol, staff director; David Affeldt, chief counsel; John Guy Miller, minority staff director; Margaret Fayé, minority professional staff member; Patricia Oriol, chief clerk; Kathryn Dann, assistant chief clerk; Gerald Strickler, printing assistant; and Dorothy McCamman, consultant.

Senator CHURCH. The hearing will come to order.

Senator Fong tells me that he will have to be absent temporarily this morning for an appointment in his office with the Secretary of the Army.

Before you leave, Senator, do you have a statement you would like to make?

STATEMENT BY SENATOR HIRAM L. FONG

Senator FONG. Yes, Mr. Chairman. I want to compliment you on the decision to hold hearings today, tomorrow, and Thursday on the report of the Advisory Council on Social Security which was released week before last and the Advisory Council's deliberations since it was appointed by the Secretary of Health, Education, and Welfare.

Nothing done under auspices of the Federal Government is more directly important to the American people than social security.

OASDI, medicare, SSI, and other Social Security Act programs are so vital to the well-being of all our citizens as a first line of individual economic security that no stone should be left unturned in our efforts to strengthen and maintain them.

Whether as beneficiaries, current or potential, or as taxpayers contributing to the system's support, all Americans are affected by decisions regarding social security's future.

This morning I will have a number of questions to address to our witnesses. For some, I would like answers today. There are others for which written answers to be submitted for the printed record will suffice.*

These hearings related to the system's recent review by the Advisory Council on Social Security are very appropriate. For several years I

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*See p. 844.

have been most concerned about social security review mechanisms. I welcome the opportunity to hear from representatives of one of them.

I strongly share the opinion of this Advisory Council that current provisions for review are inadequate. As one method of correcting this inadequacy, I have introduced Senate Joint Resolution 5 to establish an independent, bipartisan National Social Security Commission.

This proposal for continuing review of social security is cosponsored by Senators Paul J. Fannin, John Tower, Strom Thurmond, Bill Brock, Pete V. Domenici, and Clifford P. Hansen.

Because I believe it is pertinent to our work today, I ask that my statement to the Senate about Senate Joint Resolution 5, March 13, be made a part of this hearing's record at this point.

Senator CHURCH. Without objection, this statement will become a part of the record.*

Senator CHURCH. Welcome, Mr. Van Gorkom. I have a message from the Senator from Illinois, Senator Percy, who hopes to be here later this morning, but he called me to explain that he has to chair another hearing, and though he had hoped to be here at the time of your testimony, he will come as soon as he can complete that hearing, as soon as he is free.

He wanted me to explain that to you.

Mr. VAN GORKOM. Thank you.

OPENING STATEMENT BY SENATOR FRANK CHURCH, CHAIRMAN

Senator CHURCH. Today the Senate Committee on Aging continues its hearings on "Future Directions in Social Security" under circumstances far different from those which confronted us 2 years ago when the first testimony was taken.

At that time the Congress could take some satisfaction from several major achievements.

We had just enacted a 20-percent across-the-board increase.

We had established an automatic cost-of-living adjustment mechanism to keep social security benefits roughly apace with price changes.

And for those aged, blind, and disabled persons whose other sources of income just could not come close to a very meager living standard, we had established the Supplemental Security Income, or SSI, program.

It seemed like a well-balanced program, one which could be improved gradually and innovatively over the years, or even over the decades.

Well, inflation changed all that in a hurry. From October 1972 to December 1974, the increase in the Consumer Price Index was 23 percent, but the increase in social security benefits rose by only 11 percent, and to get even that increase, the Congress had to sidestep administration opposition.

Inflation still goes on, of course. And for that reason, many of us in Congress expected that the cost-of-living adjustment provision enacted in 1972 would be implemented this July and would not be tampered with. Based upon present estimates this would be about an 8.7-percent increase—just to keep up with the cost of groceries and other necessities.

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*See appendix 1, p. 859.

PRESIDENTIAL FREEZE:

But President Ford has another plan in mind. He wants to keep that increase to 5 percent, not almost 9 percent. This so-called freeze of his, I feel, makes little sense for many reasons:

(1) It ignores a compact made by the Congress of the United States with the people of the United States. That compact called for just and fair treatment, not an arbitrary limit which came right out of the Office of Management and Budget, not from any real understanding of what is happening to the old people of this Nation.

(2) The President's proposal is supposedly based upon budgetary considerations, and yet his social security scheme, as well as his proposal to increase medicare funds, distorts the budget picture considerably. He's using trust fund money to give the appearance that he is reducing an overall deficit, and this is simply not the case.

Can the President believe that most social security recipients do not need the money?

I have already said that as of December the increase in social security benefits was only 11 percent, as compared with a 23 percent cost-of-living increase.

What would happen if the full 8.7 percent automatic increase which is to go into effect this July, as mandated by the Congress, were to take effect?

Even then, the total increase from October 1972 to mid-1975 in social security benefits would stand at 21 percent, while the projected increase in the Consumer Price Index for the same period would be 8 percentage points higher: 29 percent.

As for the President's proposal: A 5-percent increase in social security benefits would bring increases since 1972 to 17 percent, 12 percent lower than the actual increase in the cost of living.

I have taken action to insure that the President's plan is rejected by the Congress, and I am happy to have the support of more than half the membership of the Senate in this effort.

We in the Senate were swayed, I think, not only by the stark statistics of cost-of-living versus social security benefits.

We also encountered, in our offices and in our home States, people who want to know how social security could help them through this perplexing period of inflation and recession at the same time.

I have pulled out from my files some of the letters received within just the past few weeks.

Let me read a few paragraphs here:

From Philadelphia, Pa.:

> I am 77 years of age, retired by compulsion in 1966, without any pension. . . . . It gets kind of sticky sometimes but I try. I am very concerned about President Ford and his austerity program. He has put a restriction on the 8.7 percent Social Security rise to 5 percent during this year, which means practically nothing commensurate with the rising prices. Still he can send millions of dollars overseas to other countries. It doesn't make sense to me.

From Flushing, N.Y.:

> I am asking you . . . for no Social Security cut in our coming increase. This increase is for last year, not even this. In my case I had to retire to care for a husband who had a stroke 9 years ago and was getting no better, so I retired in May. My rent went up twice since, plus everything else.

From Tucson, Ariz.:

> I am 85 years old. I paid income taxes 1920 to 1970—Social Security taxes 1937 to 1970. I have a home paid for which high taxes are about to take from under me. I had enough money saved for my last illness and burial. This eaten away by inflation. Very little income other than Social Security. What can be done for the millions like me—we also helped build our wonderful economy. . . . The superstores are going wild since February 1, increasing some 20 percent.

From Erie, Pa.:

> Rents hereabouts, even the slummiest, are so high, by the time they are paid, three-fourths of one's income is gone. Social Security plus SSI (Supplementary Security Income) $93 equals $185 a month. That's my only and total income. Oh, yes, $46 of food stamps for $36 (then, they are going up, too). The rents . . . well, what isn't. Think suicide will solve all problems.

Well, the Congress has to pay attention to people who tell us about the very real day-to-day crises facing older persons on fixed incomes.

Congress also has to pay attention to the alarms and warnings that are now being heard about the future of the social security system.

I do not think there can be any doubt about the fact that a reexamination of the immediate and long-range future of social security is in order.

We have never had a period quite like this before.

We have inflation and recession at the same time.

We have the prospect of a growing percentage of retired persons and a lessening number of people still in the workforce, culminating in the first quarter of the next century with the coming of retirement age by the so-called baby boom population born during World War II and in the following decade or so.

We have the growing realization that automatic cost-of-living increases must be inspected regularly and thoroughly to make certain that they do their fundamental job—keeping up with living cost increases—and do not become windfalls.

Clearly any one of these developments would represent a major challenge. But we have all of them to consider at these hearings and in other forums.

Nevertheless, I find little reason for the wave of scare stories I have seen within recent weeks about the future of the social security system.

I have seen headlines which say, in effect or literally, "Social Security Going Broke." Careful newspapers put a question mark at the end of that headline. The careless do not.

I have seen even a cartoon showing a facsimile of a social security card. Stamped across the face of it were the words: "Insufficient Funds." There was not a word more of explanation. That was it.

Yes, we do have work to do on our social security system.

We have to deal with present crises while foreseeing future adjustments, many of them of major magnitude.

But from my own analysis of the situation, we do have the time to make those adjustments. And we can preserve the essential feature of our present system while doing so.

With matters of such importance to discuss, I am anxious to hear from our witnesses, and I will now begin this hearing.

I want to acknowledge before I move to the first witness, Senator Clark has arrived.

Senator CLARK. I have a statement which I would simply like to submit for the record.

Senator CHURCH. Very well. Your statement will be included at this point in the record, and we do thank you.

STATEMENT BY SENATOR DICK CLARK

Senator CLARK. I'd like to first express my appreciation to Senator Frank Church, chairman of the Senate Special Committee on Aging, for calling these hearings on future directions in social security. The Senate Special Committee on Aging has been investigating a number of issues concerning the social security system for some time now, and this week's hearings represent a continuation of this past effort.

The social security system celebrates its 40th anniversary during 1975. Such an event might usually go unnoticed. But that will not be the case with the social security system this year because a great deal of debate has surfaced over the financial status of the system and the level of benefits it provides. The result of that debate will have a crucial effect on the lives of millions of Americans, and it is with the gravest concern for the integrity and future of the social insurance program that all of us are participating in these hearings and in the debate on the future directions of social security.

Social security is one of the most successful programs ever enacted by the Congress. It benefits virtually every member of the society—dependents, students, young workers, the disabled and older citizens—and that benefit measurably improves the quality of life for millions of Americans.

The social security program is not a "welfare" program designed to eliminate the burden of poverty. Workers contribute to the system, and in return they receive benefits as an earned right.

Social security pays monthly cash benefits to over 30 million Americans, and over 21 million aged and disabled people get part of their medical and hospital bills paid by the two-part medicare program. Social security is a disability program and a health insurance program combined, and it provides monthly life insurance when the family's breadwinner dies. To pay for these benefits, there is a financing mechanism through payroll contributions. Without this mechanism, the benefits would not be available.

The social security system is a national cooperative program, and it has allowed millions of Americans to enjoy a productive and fulfilling life without the fear of economic disaster in times of need. But over the years, some people have questioned its effectiveness. And, the inflation and recession now tearing at this country have emphasized both the need for a sound social security system and the need to correct the shortcomings of the present system.

Because of all this, I introduced S. 440—the Social Security Reform Act—on January 28. This bill is a comprehensive reform of the system. It would provide more protection for younger workers and their dependents, more protection for older workers and it would afford older citizens the income and health security that they need and deserve. The bill incorporates a series of provisions, including some that have been introduced in Congress and discussed before committees previously, and it would provide a new financing mechanism for social security and medicare.

These are some of the highlights of the legislation:

Establishment of an independent Social Security Administration.

A consumer Price Index for older Americans.

Semiannual cost-of-living benefit increases.

An increase of Supplemental Security Income payments to $2,400 a year for individuals, and $3,000 a year for couples.

Revision of the definition of disability to include occupational disabilities.

Unification of the two-part Medicare program and elimination of the $6.70 monthly premium payment.

Elimination of coinsurance under Medicare.

Coverage of out-of-hospital prescription drugs.

Establishment of a Medicare long-term benefit program.

General revenue financing for improvements in Medicare benefits provided in this legislation.

Increase in the earnings base to $18,000 in 1976, $21,000 in 1977, and $24,000 in 1978.

This legislation was designed to respond to the unmet potential and the obvious problems associated with the social security system. And, it was designed to give the consumers—those people who are contributing to the system through payroll taxes and those who receive benefits from social security—a better return on their investment.

For too many years older Americans have been struggling to live on meager incomes and suffer the consequences of inadequate health coverage. That trend must be turned around.

During the course of these hearings, we will hear stories about the discouraging long-run financial status of the social security trust funds. But we should not lose sight of the unresolved needs of this country's older and disabled Americans. So with this in mind, I look forward to this session.

Senator CHURCH. I would like to include at this point in the record a committee staff report on the impact of inflation upon the elderly, and facsimiles of several charts prepared for these hearings with the help of the Library of Congress.

[The material referred to follows:]

IMPACT OF INFLATION UPON OLDER AMERICANS—STAFF REPORT BY THE SENATE SPECIAL COMMITTEE ON AGING

From December 1973 to December 1974 the Consumer Price Index rose by 12.2 percent, the most rampant increase in over a quarter of a century. Contrary to the 1973 experience (when the increase was largely concentrated in certain areas, such as food and fuel), the 1974 inflation was across-the-board.

But in the four areas where the elderly have their greatest expenditures—housing, food, medical care, and transportation—the rate of increases exceeded the rise in prices for all other items in the Consumer Price Index by 27 percent to 43 percent. Housing, food, medical care, and transportation account for about 80 percent of the Bureau of Labor Statistics Intermediate Budget for a Retired Couple.

Percent rise in consumer price index items (from December 1973 to December 1974)

	Percent
Food	12.2
Housing [1]	13.7
Medical care	12.4
Transportation	13.3
All other items	9.6

[1] Include fuel costs.

The following tables provide additional information on the economic squeeze in which so many elderly persons find themselves because of dramatic increases in living costs. (The 5 percent increase in Social Security increases refers to the proposal made by President Ford to "freeze" a Social Security increase due in July. The 8.7 percent increase in Social Security refers to the projected increase likely to occur under terms of a cost-of-living adjustment mechanism as mandated by the Congress; this July increase would be the first automatic increase based upon increases in the cost of living.)

AVERAGE MONTHLY SOCIAL SECURITY BENEFITS

	Retired worker	Aged couple	Aged widow
December 1974	$183	$312	$177
5 percent increase	193	329	187
8.7 percent increase	200	341	194

Social Security increases lag far behind price rises

	Percent
October 1972 to December 1974:[1]	
Increase in consumer price index	23
Increase in Social Security benefits	11
October 1972 to July 1975:[1]	
Projected increase in consumer price index	29
Increase in Social Security benefits with 5 percent increase in July 1975	[2] 17
Increase in Social Security benefits with 8.7 percent increase in July 1975	[2] 21

[1] Rounded to nearest whole percent.
[2] Aggregate with July cost-of-living increase added to 11 percent Social Security raise in 1974.

SUPPLEMENTAL SECURITY INCOME STANDARDS (MONTHLY)

	Aged individual[1]	Aged couple[1]
December 1974	$146.00	$219.00
5 percent increase	153.30	230.00
8.7 percent increase	158.70	238.10

[1] Rounded to nearest dime.

POVERTY LEVELS

	1974 estimates, weighted basis
Single aged person	$2,360
2-person family with head aged 65 or older	2,980

BUREAU OF LABOR STATISTICS BUDGETS (AUTUMN 1974 ESTIMATES)

	Retired individual[1]	Retired couple
Lower budget	$3,330	$4,215
Intermediate budget	4,791	6,064
Higher budget	7,116	9,008

[1] Estimated at 79 percent of couple's budget.

What Elderly Persons Are Saying[1] About Living Costs and the Proposed 5 Percent Freeze

From Philadelphia, Pa.: "I am 77 years of age, retired by compulsion in 1966, without any pension... It gets kind of sticky sometimes but I try. I am very

[1] In letters received by Senator Church as Chairman of the Senate Special Committee on Aging within the past few weeks.

concerned about President Ford and his austerity program. He has put a restriction on the 8.7 percent Social Security rise to 5 percent during this year, which means practically nothing commensurate with the rising prices. Still he can send millions of dollars overseas to other countries. It doesn't make sense to me. Even animals take care of their own first."

From Flushing, N.Y.: "I am asking you . . . for no Social Security cut in our coming increase. This increase is for last year, not even this. In my case I had to retire to care for a husband who had a stroke nine years ago and was getting no better, so I retired in May. My rent went up twice since, plus everything else."

From San Jose, Calif.: "The senior citizens . . . know that it (the cost of living) has gone up by more than 8.7 percent . . . They also know that the essential foods have gone up over 35 percent such as vegetables, meats, flour, sugar, milk, and several other items . . . Would like to know where and how the government gets 8.7 figure."

From Long Island City, N.Y.: "There is a great deal of fear among the senior citizens at our center about the danger of Social Security continuing. We seem to have enough problems to get along without this added anguish."

From Wichita, Kans.: "Because I am active I get asked to help a lot. Here are some of the problems most often brought up: Too many are retired before they want to be without adequate income. Too many do not see a doctor because they 'know' it will be more expensive than they can afford. Many of those owning their own homes cannot keep them up and are gypped by greedy repair people. Too many withdraw from community activities and lose touch. The congregate meals here are helping but are running out of money."

From Richmond Heights, Mo.: "She (a sister with a net income of $185 monthly) lives in her own house, which needs many repairs, and, she cannot eat the shingles. In January 1973 the oil to heat the home cost 17.3 cents a gallon. In January 1975 the oil to heat the home cost 34.5 cents a gallon. The same increase occurred in the electric and telephone."

From Chicago, Ill.: "We have not been able to reconcile the 8.7 figure in any way with the consumers price index. This is causing us some concern as to whether we have a bonafide cost-of-living clause in the Social Security law or not."

From Queens Village, N.Y.: "I am 89 years old and my wife is 87 years old. I have a small home and pay taxes on it. My phone bill is so large; it's humanly impossible to keep up with my electric bill. My wife is a crippled person. Humanly impossible to walk."

(The letter then takes issue with the proposed 5 percent freeze.)

From Sarasota, Fla.: "If he (President Ford) can justify these expenditures (aid to Cambodia and Vietnam and rebates of as much as $200 in tax rebates), how in hell can he justify putting a ceiling on the cost-of-living increase to Social Security recipients?"

From Brownwood, Tex.: "If the economists would stop to consider: the more the retired person receives, the more money there will be in circulation, for they need so many things and any pension or annuity they receive will be spent."

From Cody, Wyo.: "President Ford's plan to put a ceiling of 5 percent on Social Security is shocking. His insensitivity to the plight of people on fixed incomes and the poor is appalling. Recipients on Social Security have, for the most part of their lives, supported their government with taxes, paid into the Social Security fund, not to mention State and local taxes."

From Carnegie, Pa.: ". . . the cost-of-living has been so high that any increase was gone before we got it . . . our pensions are so eroded that all we can do is buy the least expensive food we can find and wait each year to find out how much our rent was going up."

From Santa Rosa, Calif.: "I am sure you will not be a party to ripping off the senior citizens by lowering the scheduled increase of 8.7 percent in Social Security. As a matter of fact, to compensate fully for the increase in living we should ask for an increase."

From Yucaupa, Calif.: "With the cost-of-living, gas, light, water, phone, medical bills, hospital, insurance, rent, what are people to do. . . . We need and want a raise in Social Security."

From Stoney Brook, N.Y.: "I have worked all my life to support myself and my family (being a widow for 30 years) and have contributed to Social Security to make sure when I retire I will have adequate Social Security to live on. Never collected unemployment. Now I understand we are to get an 8.7 percent increase cost-of-living expense and instead we are told it will be 5 percent. I am very bitter and disturbed.... We cannot maintain good health if we cannot buy food and necessities."

From Pittsburgh, Pa.: "The Government should be ashamed at themselves fighting over what to do about Social Security. Trying to cut it down is like cutting our throats."

From Maywood, Ill.: "Inflation is stealing from my lifetime savings. Unless inflation is abated soon, I may be among those low-income senior citizens on relief during 1975–6. I believe Congress and the Senate should veto the President's proposed 5 percent limit in his S.S. program and enact their own law with payments to conform to the cost-of-living index, as means of arriving at living cost adjustments."

From Tucson, Ariz.: "I am 85 years old: I paid income taxes 1920 to 1970—Social Security taxes 1937 to 1970. I have a home *paid for* which high taxes are about to take from under me. I had enough money saved for my last illness and burial. This eaten away by inflation. Very little income other than Social Security. What can be done for the millions like me—we also helped build our wonderful economy.... The superstores are going wild since February 1, increasing some 20 percent."

From Erie, Pa.: "Rents hereabouts, even the slummiest, are so high, by the time they are paid, three-fourths of one's income is gone. Social Security $92+ SSI (Supplementary Security Income) $93=$185 a month. That my only and total income. (Oh, yes, $46 of food stamps for $36.) (Then, they are going up, too.) The rents . . . well, what isn't. Think suicide will solve all problems."

From San Diego, Calif.: "We have been disturbed for a long time at the manner in which our Government always seems to use the needs of the elderly and the poor as the targets of budget cuts. Of course, this is the easy way, as they have no lobby operating for us."

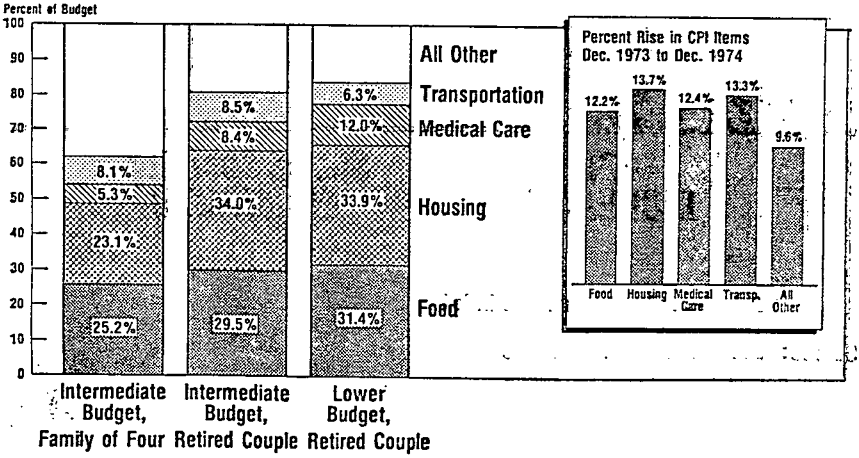
From Hollywood, Fla.: "I am past 84 years, maintain a home, work in yard, drive to do errands, put in one to three days as Volunteer in nursing home since November 1967. Doing okay. But please help our needy."

From Sarasota, Fla.: "My rent (I live in a mobile home park) was raised $20 more a month last month. We buy day old bread. Milk is 50 cents a quart. A 6 percent increase in our Social Security would come to $16 a month. The rent increase takes more than that."

From Wilmington, Del.: "We cannot afford a healthful diet and if we get sick we can't afford a doctor's office visit and medicine."

CHART I

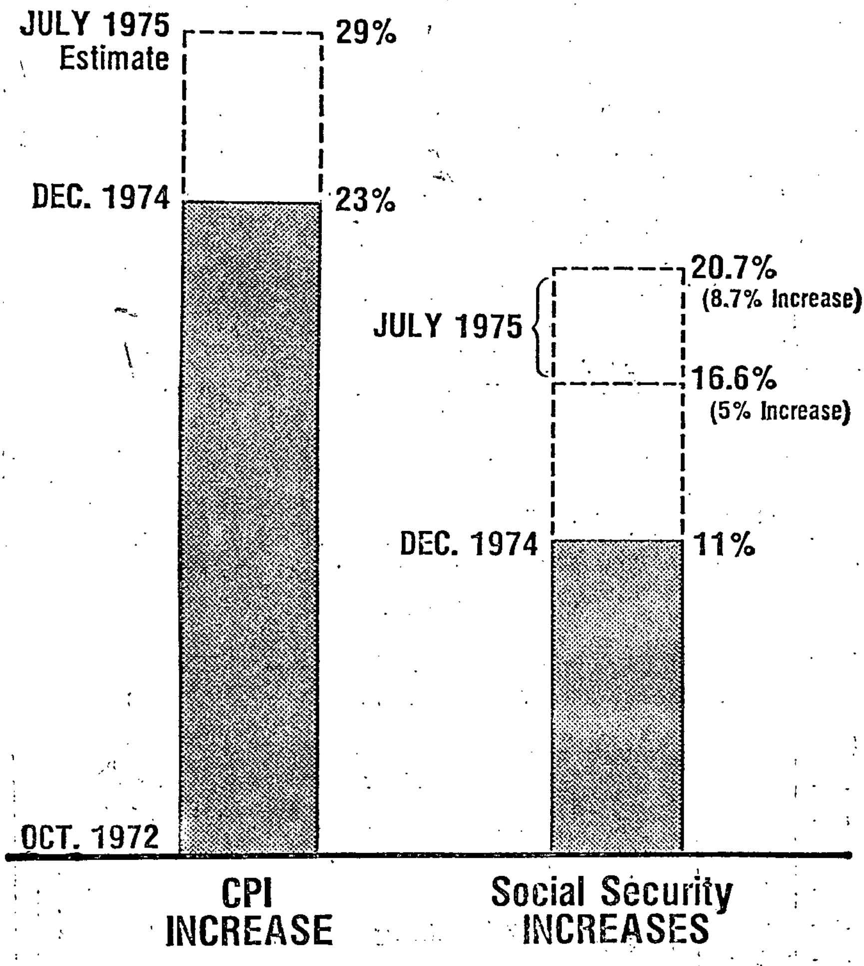
Price Rises Are Especially Severe For the Elderly - - -
Items That Take Most of Their Budgets Are Rising at Faster Rates



Source: Bureau of Labor Statistics, U.S. Dept. of Labor, Autumn 1973.

CHART II

SOCIAL SECURITY INCREASES LAG FAR BEHIND PRICE RISES*

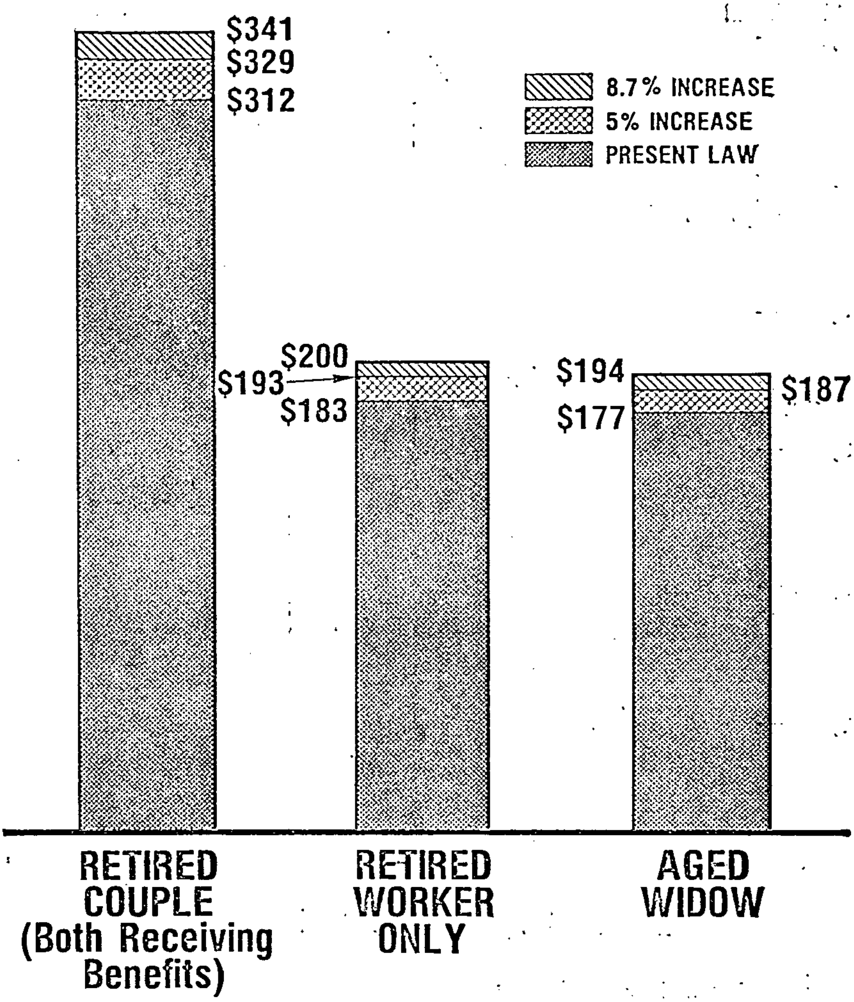


* Based on Consumer Price Index

Source: Bureau of Labor Statistics

CHART III

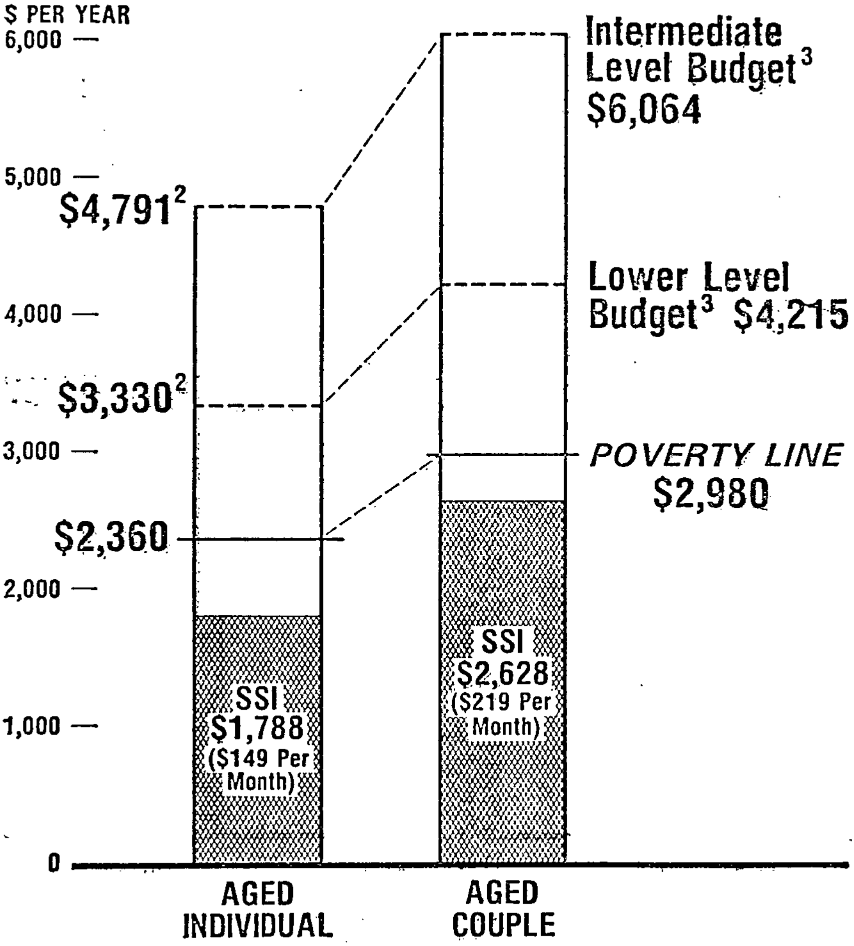
AVERAGE SOCIAL SECURITY BENEFITS DEC. 31, 1974, AND PROPOSED CHANGES



Source: Social Security Administration

CHART IV

SSI[1] LEVEL FALLS FAR SHORT OF ADEQUACY (AS OF DECEMBER 1974)



1 Supplemental Security Income
2 Estimated at 79% of couple's budget
3 Estimated as of December 1974 by Bureau of Labor Statistics

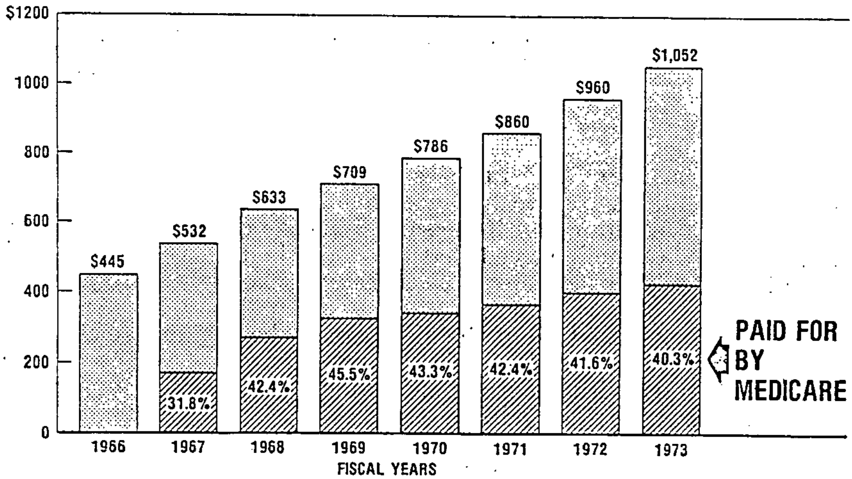
CHART V

MEDICAL CHARGES SOAR

	1966	1975	PERCENT INCREASE
HOSPITAL INSURANCE			
DEDUCTIBLE	$40	$92	130%
CO-INSURANCE			
HOSPITAL			
1st - 60th DAY	NONE	NONE	—
61st - 90th DAY	$10 DAILY	$23 DAILY	130%
LIFETIME RESERVE DAYS	$20	$46	130%
NURSING HOME/EXTENDED CARE			
1st - 20th DAY	NONE	NONE	—
21st - 100th DAY	$5 DAILY	$11.50 DAILY	130%
MEDICAL INSURANCE			
PREMIUM	$3.00	$6.70	123⅓%
DEDUCTIBLE	$50.00	$60.00	20%
CO-INSURANCE	20%	20%	—

CHART VI

MEDICAL CARE BILL PER AGED PERSON AND PROPORTION COVERED BY MEDICARE, FY 1966 - 1973



Source: Social Security Administration

Senator CHURCH. We will now move to our first witness, J. W. Van Gorkom, president, Trans Union Corp., and Chairman of the Advisory Council's Subcommittee on Finance.

STATEMENT OF J. W. VAN GORKOM, PRESIDENT, TRANS UNION CORP., AND CHAIRMAN OF THE ADVISORY COUNCIL'S SUBCOMMITTEE ON FINANCE

Mr. VAN GORKOM. Thank you, Senator. The entire Council worked very diligently, I might say, for about 9 months, because we all have a deep interest in the future of social security.

We recognize that 90 percent of the workers are covered by it, and there are over 30 million beneficiaries. We believe the system has worked well. We want to try to help it continue.

I am speaking today on behalf, of course, of W. Allen Wallis, chairman of the committee, and I have submitted for the record a short statement which he prepared.*

Questions were sent to me, which apparently the committee would like me to address myself to, some of the questions were intended for Mr. Wallis, and in his place, Mr. Weber, and also for me, and I am going to try to answer all of them.

Before I do, however, I would like to address the committee on a most important recommendation of the Council itself.

COMPUTING THE BENEFITS

It is probably the most noncontroversial recommendation the Council made, and the Council felt it was the most important recommendation that it made, and that was to correct the basic flaw that presently exists in the method of computing the benefits. I would like to address myself to that first, if I may, and may I use the blackboard, please?

Senator CHURCH. Yes, please, I think we will need the blackboard to understand.

Mr. VAN GORKOM. We had three actuaries and two economists who advised us, and the Senate Finance Committee also hired a group of outstanding consultants with the same type of talent, and all of them, and all of our Council agreed that this flaw should be corrected.

Unfortunately, it happens to be exceedingly complex, or appears to be complex. It took the Council 2 months to understand the problem.

While I assume that all of the members of the Committee on Aging are quite familiar with the Social Security system, I want to be sure that we all start with the same background. I will therefore present some basic facts to start with.

The tax paid by workers is the same for everybody, but the benefits are not. The benefit schedule is weighted in favor of the low-paid employee, and everybody agrees with that as a proper social objective.

For example, the tilting is very heavy at one end of the scale. The first $110 of average monthly earnings receives a benefit of 120 percent.

The next $290 falls all the way down to 44 percent, and thereafter, additional amount of average wages go all the way down to 20 percent,

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*See appendix 2, item 1, p. 863.

so you can easily see that the benefit schedule is tilted very heavily in favor of the low-paid employee.

The most important single criterion in trying to determine the efficiency, or propriety, of a wage-replacement system like social security is what is called the replacement ratio, and that is not a very complicated thing.

If, just before a person retired, he had earnings of $500 a month, and his retirement benefit is $300 a month, then he has a 60-percent replacement ratio. That replacement ratio is very important, because it tells you how good a job you are doing in replacing this man's wages.

Can everybody hear me?

Senator CHURCH. You are doing fine.

Mr. VAN GORKOM. The ideal system would have Congress determine just what is an adequate replacement ratio, and then fix it, and maintain it thereafter.

The trouble with the present system is that Congress does not have control over the replacement ratio, because it fluctuates both up and down, as wages and prices move in relation to each other, and the fluctuation of this replacement ratio everybody concedes to be a bad thing.

Now, in looking at some actual examples, as you might expect, with the kind of weighted benefit schedule I have described, the replacement ratio varies between high-paid and low-paid workers, and here is a concrete example.

REPLACEMENT RATIO FLUCTUATION

A man who has worked pretty much at the minimum wage level, most of his working career, will have a replacement rate today of approximately 62 percent, and the high-paid individual will have a replacement ratio of about 32 percent.

Now, the high-paid individual will have an absolutely higher amount of benefit, but it will be lower in relation to his wages.

To show you how the replacement ratio can fluctuate, let us take this low-paid individual, who has a 62-percent replacement ratio, as an example. Let us assume that wages go up at a compounded rate of 5 percent over a period of time, but that the cost of living, which I will call COL, cost of living, goes up at only 2 percent. In these circumstances, the 62-percent replacement ratio will gradually fall down to about 44 percent. If, however, the cost of living goes up at 4 percent, wages staying at the same 5-percent rate of increase, then the 62-percent replacement ratio will go up to 1.65 percent. This means that at retirement, his benefits will be 165 percent of what he was actually making at the time he retired.

Now, the important thing is not whether 62 percent is the proper ratio or not. I make no argument either in favor of it or against it. The important thing is that under the present system, with no action by Congress at all, the movement of wages and prices can cause a man's replacement ratio to go from 62 percent down to 44 percent or up to 165 percent.

All of the people addressing themselves to this problem feel that this situation is most unfortunate. A wage replacement system should not function in this way, and they believe it should be changed.

Senator CHURCH. May I ask you——

Mr. VAN GORKOM. Please do. Interrupt at any time.

Senator CHURCH. Is there any justification for the wage replacement to exceed the actual earnings of a retiree?

Mr. VAN GORKOM. Under the present system, there is a rationale for it, and that is this: If you take a man's working history today, we compute his benefits on the basis of his actual wages after 1950. We are faced with the fact that his actual earnings back in the 1950's and 1960's were very low in relation to wages and the cost of living today.

I think you can rationalize the idea of having replacement ratio today of 120 percent of the lowest part of the wages, otherwise his benefit would be too low in relation to the inflated price structure of today because of his low wages back in the 1950's and 1960's.

Senator CHURCH. But when you defined replacement ratio, you spoke of it in terms of the ratio between the benefit that the retiree would receive, as compared to his——

Mr. VAN GORKOM. Most recent wages.

Senator CHURCH [continuing]. Most recent wage, and I can see a justification, if you can go back to wages, as early as the 1950's, crank in the inflationary factor, but if we accept your definition of a replacement, of the replacement ratio, as related to his most recent wage, would there be any justification, or rationale for permitting a benefit that exceeded 100 percent?

Mr. VAN GORKOM. No; and the Council definitely decided, as a matter of policy, that in a proper system benefits should never exceed 100 percent of the wages they were designed to replace, and that was one of their basic requirements of the new system.

The truth is that if a man today has current wages of $500, they are reasonable in relation to today's cost of living, but his actual average wage for the period after 1950 might be only $200, because wages and prices have risen so rapidly since 1950. Therefore, they do rationalize that you can have a replacement ratio of more than 100 percent in today's system, but not in the proposed system that I will describe now.

INDEXING WAGES

One of the questions directed to me had to do with the concept of indexing wages, and I can discuss that at the same time. One of the elements of the proposed system is the indexing of wages. Instead of taking the actual wages during a man's life, we would take his actual wages in each year after 1950 and adjust such actual wages to their 1975 equivalent by the use of an index.

That means that if he made $200 a month back in 1951, and the average wages today are double what they were back in 1951, then for this year, we would have actually credited him with $400 in computing his benefits. If in 1960 he made $300, but average wages today are 150 percent of 1960 wages, then we would credit him with $450, so that his average wage, on the basis of which we figure his benefits, would no longer be the actual wages earned during that period; they would be those wages indexed up to the year before his retirement.

That has some other collateral benefits, which I will not go into in great detail, except to say that it would produce greater equity in the amount of benefits between people who retire at different times. This has been fully explained in the Council's report.*

*See appendix 3, item 3, p. 871.

Senator CHURCH. Would it be accurate to describe that indexing method as a way of determining the beneficiary's real income during this earning period in terms of——

Mr. VAN GORKOM. I would have to say no. What is generally referred to as his real income is his increase in wages, reduced by the increase in the cost of living. Over any reasonable period of time, the cost of living never increases as fast as the cost of the increase in wages, so the indexing I have described would produce a somewhat higher result than what is generally referred to as the real increase in wages.

Over a 20-year period, from 1950 to 1973, or so, wages did go up an average of about 5 percent, and the cost of living went up about 3 percent. History tells us that wages do rise faster than the cost of living, but only over a reasonable period of time; in the short run the reverse can be true.

WAGE, PRICE RELATIONSHIP

Over the past 18 months, this relationship of wages and prices has been badly distorted, with price rises actually exceeding wage increases, but that is not normal, and when you are examining a plan like social security, you have to think in very long terms. However, right now, this disturbed relation has created a very real financing problem for the system, even though we hope it is of short duration. The problem is that we don't know if or when the historical relationship of wages and prices will resume. In the meantime, the automatic benefit increases have resulted in an excess of outgo over income.

The other major aspect of the new plan will be a new and different benefit formula.

Today, we have a graduated formula with seven or eight steps, starting at 120 percent and going all the way down to 20 percent.

Naturally, the average monthly indexed wage is going to be much higher than the actual average wage. Therefore, the benefit ratio will have to be smaller. It should also be simpler and it can be with indexed wages. There is no one benefit formula that anybody can say is absolutely correct.

To develop the new formula, Congress will have to work with the Social Security Administration, consulting actuaries and anybody else that can provide a useful input. I would have to say it would probably take 6 months to a year to develop a formula acceptable to all. Here is an example of the kind of formula we are talking about: On the first $123 of average indexed wages. we would provide a benefit of 100 percent. This is in keeping with the thought you expressed before, that we do not want to go over 100 percent. There is no need to do that if you index wages.

For all average indexed wages above $123 we would have a flat benefit rate of, say, 31 percent. It must be noted that the $123 figure would rise each year in accord with the rise in average covered wages.

This is a much more simple formula. I want to stress that this formula can be so arranged that it will approximate the benefits that are given under today's plan if that is desired. Furthermore, the two systems can be meshed together during an implementation period, so that no one ever suffers a reduction of his benefit as you gradually shift over to the new system.

Furthermore, I would emphasize that the concept here is to freeze or stabilize the replacement ratio. That does not mean you are going to freeze his benefits.

After his retirement, a worker's benefits will continue to go up with the cost of living, but replacement ratios will be stabilized and that is all that is really sought here.

Again, I would emphasize to the Council, and in Mr. Wallis' statement* to you, he emphasizes that the Council thinks this is the most single and important recommendation that it made. It will improve the entire system, and it will probably help alleviate some of its long-term financing problems.

You cannot be positive that the new system will save money. However, on any reasonable assumption as to what the long-term increase in wages and cost of living will be, it will prevent benefits from reaching levels such as 165 percent in the future.

Senator CHURCH. While you are at the blackboard, will you explain the flaw, and the effect it has in creating a double dip in respect to cost-of-living adjustments?

COST-OF-LIVING ADJUSTMENT

Mr. VAN GORKOM. I think I can. As long as wages rise about 4 percent and prices rise about 2 percent, you will have stable replacement ratios under today's system.

The problem arises when this relationship changes, and of course we are much less confident today than we used to be about maintaining that kind of relationship over a long period of time.

Under the present law, when the cost of living goes up, the benefits go up, but the benefits go up by raising the entire benefit schedule. For example, if the cost-of-living goes up 8 percent in July the entire benefit schedule will be raised by 8 percent.

Now, that means that all of the people who are now retired will get benefits that are 8 percent higher, but it also means that everyone who is going to retire in the future will also get this higher benefit schedule.

At the same time, we know that wages almost invariably rise even faster than prices. People who are still working will benefit from the wage rises because their average monthly earning will increase and this increases their benefits. When they retire, they will get both the higher benefit due to the increase in average monthly earnings and also the increase due to the higher benefit schedule.

That means that the workers who are still working get their benefit-ratio increase coupled with their wage increase, and that is what they mean by a coupled system. The only way to correct this is to decouple the system.

To decouple the system, you provide that while you are working, benefits shall go up solely on the basis of increase in wages, and after you have retired benefits shall go up only on the basis of the cost of living. That is what the new system proposes. The formula would not change with the cost of living, as it does today; each retiree's benefit would be increased directly by the rise in the cost of living.

If you do that, then you will have decoupled the system and you will have stabilized the replacement ratio. You will have created a system

*See appendix 2, item 1, p. 863.

that will produce costs that are commensurate with the benefits you are trying to provide.

Senator CHURCH. Now, this decoupling formula, that can be enacted into law at any time, that does not require further study?

Mr. VAN GORKOM. The precise formula will depend on the goals of Congress and the date of its implementation. I can only stress that a great deal of time and thought will probably be required to develop it.

This $123, for example, will depend upon whether you implement it January 1, 1976, or 1977, or 1978.

Incidentally, that minimum amount of $123 on which you were going to pay 100 percent, that will rise every year with average wages.

That is an important element of the total plan. Today, you know, the maximum amount of wages that is subject to tax keeps going up every year in accordance with the increase in the average wage.

Are there any further questions about cost of living?

Senator FONG. When you give the cost-of-living, say 8.7 percent, where will you get that money?

Mr. VAN GORKOM. I would like to ask you to hold that question a minute, Senator Fong, as I am going to come to the question of deficits in a moment. In fact, that is the next question.

Is there anything else with regard to the mechanics of decoupling?

FINANCING THE PROGRAM

I have a question addressed to Mr. Weber, the vice chairman of the council. He cannot be here, so I will try to answer it. It says "Council members unanimously endorse the fundamental fact that earnings-related benefits of the social security program should remain the Nation's primary means of providing funds. Please give the major reasons for this declaration, et cetera."

I think what is really being asked here is how are we going to finance the program, and there was considerable amount of debate on this point among the members of the council.

The majority of the council believes that the present method of financing the system, by taxes on wages, should be maintained. The minority believes that general revenues should be introduced into the system. I am now going to address myself to the argument for the majority, that the funding of social security benefits, including any proposed increases, should be financed on the basis of continuing taxes on wages, and without the introduction of general revenues.

I would like to say at the beginning that the majority is not at all insensitive to the problems of some social security beneficiaries who receive an insufficient benefit and have no other means of support. We recognize that as a problem, but believe that the solution of it lies in another direction. Let me try to develop this in a little more orderly fashion. When social security was established, it was never intended that it would be the sole support, or could be the sole support, of people after they retire.

The basic concept was a three-tiered system. The first part would be social security, and there are several characteristics of social security that I think need to be emphasized. First, from the very beginning the plan has been contributory with the employee paying taxes while he is working.

Second, the taxes paid are based on the amount of wages earned.

Third, his benefits are geared directly to those wages so that the benefits and the wages have a relationship.

It is not a perfect relationship because in order to attain certain social goals, concessions and compromises have been made, such as the weighted-benefit schedule.

We do not have a straight line benefit schedule; we have one weighted in favor of the low paid for obvious reasons, but there is still a direct relationship between wages and benefits.

Fourth, there has never been a needs test in social security, meaning that no one has to prove poverty to obtain his benefits. Social security benefits are paid as a matter of right, and I think everybody agrees this is a proper objective. A worker pays taxes while he is working, and, therefore, he is entitled to social security benefits at retirement or disability, and that is a fundamental part of the whole social security system.

Private Retirement Resources

The second part of the three-tiered system is private resources. This includes the more obvious ones, such as savings that people accumulate over their lives and which are invested in stocks and bonds, et cetera. It also includes private pensions, which are constantly growing in importance and getting bigger. Under recent legislation of Congress, private pensions will become an even more important part of the wage replacement structure of this country.

Private resources are very important to this country, because they perform the largest part of the capital formation function and capital formation in this country is at this point a major concern of businessmen and the country in general. Capital fuels the economy of the United States, and, therefore, the maintaining of private resources, and a need for an incentive to accumulate private resources, are very important to the economic health and growth of the country.

It was also recognized from the beginning that even with social security and private resources, there would still be people who would not have what society figured as an adequate amount to sustain themselves, so there was a third tier to the program which consisted of what I will call needs programs. They come in many forms, but basically they are programs which provide money to people who do not have enough in social security, or from private resources, but who can demonstrate a need. These programs are funded from general revenues and should be so funded.

The most perfect example of a needs program today, I suppose, is the SSI program, the supplemental security income program, which we think is an excellent illustration of the third tier.

The social security program we feel has been successful because, since it has been contributory, and its benefits are wage related, the employee, the man who pays the taxes, feels a responsibility for the system. He feels he is paying for it, supporting it. He knows that if benefits go up too high, he will have to pay an increase in taxes, so he accepts a responsibility for the system.

Today, of course, with rises in the cost of living being out of balance with increases in wages, the tax burden is becoming a real problem for the people at the low end of the wage scale.

The total social security tax including medicare is just under 6 percent. We have recommended the OASDI tax be increased, because of the deficit problem, which I will discuss in a moment. We realize that this will impact heavily on the man who is at the low end of the economic scale.

We also know that there are some people who need more benefit help, too. There are some people who do not get enough out of the first two tiers, and this has prompted the request for general revenues to be infused in the social security program.

Use of General Revenue Funds Opposed

The majority of the Council opposed the infusion of general revenues into the social security system. Basically, the majority believe that the basic characteristics of the plan will be changed, and changed unfavorably, if you introduce general revenue. It will diminish the relationship between taxes paid by the worker and the benefits he receives. This will reduce his sense of responsibility for the system.

There is also the fact that if general revenues are employed, benefits will then become a part of the total budget making procedures. When the pressure is on to reduce the budget, there is always the danger they will reduce social security benefits.

Probably the most important way in which use of general revenues would change the character of the system, is that it would ultimately lead to a needs test. In other words, eventually the benefits would not be paid as a matter of right; they would be paid only if a need could be shown.

The people who want to use general revenues are insistent that no needs test be introduced in social security, but in my opinion you cannot employ general revenues in any program without having a needs test, and I shall try to demonstrate that.

What is the real pressure today for using general revenues in social security? It arises from the fact that some beneficiaries still receive inadequate benefits.

Let us assume that this square represents all of the beneficiaries, some 31 million today.

We know there are some people in this group who are not receiving a sufficient amount of money to support themselves. I do not want to get into a debate of how much that is, so let us assume it is x dollars. There are in this total group of beneficiaries, then, a number of people who are getting less than x dollars.

To help these people we have three choices if we put in general revenues. First, we can increase the total benefit schedule, so as to help all of the 31 million beneficiaries. This would help those who receive less than x dollars per month, but we will also be paying more to everyone else, and a lot of the beneficiaries do have enough social security. They already receive x dollars or more in benefits. To help the small number who have less than x dollars, you will be raising the benefits of all who have more than x dollars. This means a very high cost and I do not believe proponents of general revenues would ask to have the total benefit schedule increased.

More likely, they will try a second alternative. They will propose a minimum benefit of x dollars, and that, at first blush, seems like a good solution.

The problem is that there are a lot of people who are getting less than x dollars, but who have private resources in the form dividends or interest or private pensions. Many people work only sporadically, because they have independent incomes.

Even more important, there is a large number of people who receive less than x dollars from social security, but who have worked a large part of their lives in noncovered employment and are receiving another pension. For example, take a person who has worked 30 years for the Government and then, in the last 10 years of his working years he leaves the Government and takes a job covered by social security. In this employment he earns benefits, most of which are at the 120 percent level intended for low-paid workers. In my example, it is paid to a high-paid worker who has worked only a short time.

THE "WINDFALL" PROBLEM

Let me digress for a moment and say the council spent a lot of time on this problem, the windfall problem, which I have just described. There is today a minimum social security benefit, and we know that a lot of people are receiving that minimum benefit who also have private pensions, primarily pensions from the Government. I do not refer only to the Federal Government; I mean the State and local governments as well, because their employees are the largest group outside social security coverage.

In fact, so prevalent is this concept of working for a while under a plan that is not under social security, and then leaving it to earn the minimum social security benefit, that in some instances, whole fire departments and police departments are opting out of social security, so they can take advantage of this "windfall" possibility.

A study a few years ago indicated that some 40 percent of all Federal employees who had pensions were also getting social security benefits.

What I am stressing is that you cannot say because a man has a social security benefit of less than x dollars, that social security is his total income.

He may have other sources, therefore, you come down to the point if you want to help the people who really need help, you have to put it on a needs test. You have to require that they establish that they have less than x dollars.

Senator CHURCH. Accepting your argument, because I think it is very persuasive, why does not it follow that if financing out of general revenues will lead to a needs test, as indeed it does in the case of the SSI program, which is financed out of general revenues, then does not it also follow that your recommendation to finance medicare out of general revenues will also lead to the establishment of a needs test in the medicare program?

Mr. VAN GORKOM. Yes, I think it does, and what I find most puzzling is that some people oppose general revenues for medicare because it will lead to a needs test, but they demand general revenues for OASDI and insist that there be no needs test.

Today, social security has no needs test, because it can be persuasively argued that the people who receive social security benefits have paid for them and have earned them.

But the minute you introduce general revenues, you are asking people to provide benefits that the recipients have not paid for. Therefore taxpayers will say: "I will help you if you need it, but I will not help you if it merely increases money you already have." If a needs test is introduced in social security, then the concept and philosophy that underlies the whole program, and which has sustained it for 40 years, will be lost.

Senator CHURCH. Is not that also true of medicare?

Mr. VAN GORKOM. Well, no, I think medicare is different, and I might just as well try to explain that, because the same question was asked me about medicare.

First, however, I want to make a couple of preliminary remarks. We did take up the question of medicare at the end of our meetings because the OASDI program was so complicated that it took most of our time. However, that does not mean that we gave a short shrift to medicare, or that we did not consider the problem in sufficient depth.

FINANCING MEDICARE

Second, I want to make it very clear that we did not vote to fund medicare from general revenues in order to solve a financial problem of the OASDI. It so happens that if medicare is financed by general revenues, it will free up some money now being paid under the social security tax on wages, but that was not the primary principle. We did it because we could not see any logical reason for using a tax on wages to fund a health plan.

The retirement and disability parts of social security are wage-related, wage-replacement plans. There is a very sound reason for financing them by a tax on wages, because the benefits are geared to wages. The benefits of medicare are not related to wages in any way.

The only similarity between medicare and social security is that they are both geared to helping people who are in their later years, but they are two entirely different plans.

Financing medicare from general revenues is not a novel idea. When medicare was first introduced in Congress, there was considerable debate in Congress as to how it should be financed. Some Congressmen were in favor of financing it from general revenues, and other people wanted to finance it by a tax on wages.

John Byrnes, who was on the Council, was in the Congress at the time he tells us the issue was compromised eventually by taxing wages to fund part A of medicare while a portion of part B is financed from general revenues.

There is another important factor that influenced the Council in its recommendation. It is generally agreed that very soon we are going to have some kind of a national health insurance plan which will cover everybody. If that happens, and I think it is only a matter of time until it will, then the medicare program will probably be taken out of social security and put into that total plan, and I would not assume that the national plan will be financed by a tax on wages.

I cannot say, of course, that a tax on wages is any worse than a Federal sales tax, or something like that. I can only say that there is no sounder reason for taxing wages to support the medicare plan than there is for using general revenue.

Senator CHURCH. Except for this—and I get back to it again—except for your argument that if medicare is financed out of general revenues, it will lead eventually to a means test.

I believe the concept of medicare—maybe the reason that this was worked out, was that this care should be provided the elderly also as a matter of right, based upon the contribution that they made during their working years, and that they are entitled to that medical care in their retirement years would be as definite, as fixed, as they have an entitlement to benefits under the social security system.

A MEANS TEST FOR MEDICARE

The only real concern I have with your recommendation, is that I also feel if we move away from that, and begin to finance medicare out of general revenues, we will end up with a means test, and all of the difficulty that entails.

Mr. VAN GORKOM. Senator, would you agree if a national health plan of broad scope is developed, it would naturally encompass what we now call medicare?

Senator CHURCH. I think it would. I hope that we do not dilute the medicare program in order to get a national program. There are serious gaps now and the greatest need for it.

I agree, that if we go to a national health program, medicare will be a part of it.

Mr. VAN GORKOM. Reasonable people can differ on this. The Council majority felt if the benefits were not wage related, it should be financed by general revenue.

Senator FONG. Will you give us the thinking on whether the cost-of-living allowance which has now been given, is wage related?

Mr. VAN GORKOM. The cost of living, well, it is in this sense. What they call the primary insurance amount is always based on wages, and when the cost of living rises, the total benefits structure is increased with the cost of living. Since that benefits schedule is always applied to the average monthly earnings, the increase is still wage related.

This is not a good way to do it, Senator. What we want to do is, of course, have the primary insurance amount based entirely on your earnings until you retire, and then after you retire, shift over to having the cost of living applied to your benefits to maintain your purchasing power.

Senator FONG. After you retire, then you have been paid for the cost-of-living allowance, have you?

Mr. VAN GORKOM. Well, that is why I think we have to go back to figure out what is happening here. If the cost of living rose equally, it would rise during the period in which you are paying taxes, and it would also rise after you retire.

There is not perfect equality in these systems, because the cost of living may go up very slowly while I am paying taxes, and it may go up faster after I retire, and, therefore, I may get a disproportionate additional benefit, so it is not a perfect relation. It is close enough, however, so that there is a recognition at this point on behalf of the worker, that there is a relationship between his average monthly earnings, and the benefit he will get, including cost of living increases; but you are correct, it is not absolute by any means. If you start introducing Federal revenues, you further distort this relationship and you will lose sight of it altogether.

THE NEEDS PROGRAM

Senator FONG. But if you took the cost of living out, and tried to put in a needs program, you might get a better relationship in the percentages.

Mr. VAN GORKOM. Yes; except that if you do that, you see, if you take general revenues to pay the cost-of-living increase to everybody, it will be a very substantial amount of money, and you will be helping a lot of people who do not really need it, but that has been suggested.

It has also been suggested that Federal revenues be used only for the disparity in the benefit schedule; to fund the difference between the 44 percent and the 120 percent. This would represent, you might say, the social goal.

Senator FONG. What is the thinking of the Commission on the needs program, how do you handle it, you have social security, you have private pensions, and now the needs program.

Mr. VAN GORKOM. We think that is a very important part. We think all three of these are important.

We think the first, social security, has worked very well, we think the second is also very important because from it comes the largest part of capital formation, and we know that the third is important, because there are some people who do not get enough from the first two. We do want to help those persons, but we want to help only those who need it, and, therefore, we think if Federal general revenues are to be used, we will need a needs test, and that is probably true of health care too. But the general revenue help should be kept outside of social security, because it permits you to solve this problem of the people who do not have enough to live on.

There is no need to use general revenues within the social security system. If a needs program is required then it should be added outside the system, like the SSI system. It can then be funded with general revenues.

For example, one of the things that the Council considered was raising the maximum covered wage. Today the social security tax only applies to the first $14,000 of wages. That amount goes up every year with average covered wages.

If you receive wages above that, you do not pay any social security tax on the excess. We thought for a while that we might relieve the deficit problem by increasing this maximum to $24,000. Others have proposed $28,000.

Such an increase would bring in more taxes while the additional benefits paid would be very small in the beginning. As a result, it would help solve the deficit.

If, however, you raise the limit to $24,000, and start putting a tax on that amount, you are going to be infringing on the second tier of the total program, namely, private resources. Money which would otherwise be saved by earners will be paid into social security and distributed to people who will spend it immediately. We actually voted for that idea at one time, but at the next meeting, we disavowed it. The Council believed that those who received earnings of $24,000 would be inclined to save a portion of the amount over $14,000 and taxing the excess would reduce the amount of that saving. The Council wants to maintain all three parts of the system and raising the limit would jeopardize the second part, private resources.

I would like to talk just a little bit about the deficit itself, because one of the questions given to me was: "Recent newspaper accounts have indicated that the old age and survivors trust fund may be exhausted by 1981. This has caused concern for many social security beneficiaries. In your judgment, do people drawing benefits or in the future need to be concerned about receiving social security checks?"

Well, the deficit that social security faces is not really a single deficit. It is really two deficits, and they arise from different causes. I would like to talk about that very briefly.

We have a short-term deficit and a long-term deficit. The short-term is the most serious, but I shall begin with the long-term deficit.

The Long-Term Deficit

The long-term deficit is demographic in origin. This means that its cause is rooted in basic changes in population. From the blackboard you can see that the birth rate rose sharply from 1945 to a peak in 1957. It came down slowly and recently it has plunged below the replacement rate. It is expected to remain below the replacement rate for some years and then rise back to the replacement rate.

This means that we had a lot of people born in this area here from 1945 to 1970, and when you get out over here to the year 2005, these war-babies people start becoming beneficiaries of social security. From that point the number of beneficiaries rises rapidly. From the year 2005 to the year 2030, you have more and more beneficiaries drawing benefits, but because you have a low birth rate from 1970 onward, you have fewer people, relatively, paying taxes.

Today you have 30 beneficiaries for every 100 workers. When you get to 2030, you will have 45 beneficiaries for every 100 workers, and what that means is that the taxes to be paid by these 100 workers will be a lot higher in 2030 than it was in 1975. That is where the deficit comes in, and that is why to finance the deficit, the tax will have to go up. The argument is made that if the birth rate is so low these people in 2030 can afford to pay more to support them, because they will have fewer children to support.

It is very difficult to forecast birth rates, because they are influenced by so many psychological factors. No one can be sure of the population composition in 2005. On the other hand the long-term deficit is now double that and it may go even higher.

This is assuming that wages and prices do not get too far out of line.

Senator FONG. If the number of beneficiaries is 1 to 3; is that sufficient?

Mr. VAN GORKOM. That is where we are today.

Senator FONG. That is where you are today. Is the money coming in now sufficient to pay for the people who are taking benefits?

Mr. VAN GORKOM. It is not sufficient right now, but that is for another reason, and I will now talk about the short-term deficit, which I think answers that question.

Senator FONG. In the long run, will that be sufficient, if you have three workers?

Mr. VAN GORKOM. If wages rose at the rate of 4 or 5 percent, and the cost of living only went up about 2 percent, then you could handle that without a great deal of trouble.

Senator FONG. At 3 to 1?

Mr. VAN GORKOM. At 3 to 1.

INCREASE RETIREMENT AGE?

Now, that is my understanding. I am not an actuary. I might add that because of this disparity in the number of wage earners, and the number of beneficiaries, the Council did recommend that at some time in the future, the Congress consider increasing the retirement age from say 65 to 68. We received a tremendous amount of criticism about that.

Senator FONG. I already have gotten a lot of letters on that one, and the reason is all of the pressure is the other way.

Mr. VAN GORKOM. Today, the number of people in the labor force is growing as the "war babies" come of age. Today, everybody wants to retire earlier, not later. People cannot seem to envision what will happen after 2005, when the labor force is not rising and the number of beneficiaries is going up. By that time we will also have 30 years of increases in health care, longevity, and so forth. Certainly one way to keep the tax at a more reasonable level, would be to ask people to work until 68 rather than 65. We opened a hornet's nest with that suggestion, but the concept is still very sound.

If the number of beneficiaries rises dramatically in relation to the number of workers, you may have to increase the retirement age.

Senator FONG. Those that have not retired at 65, but will get their retirement at 72, are saying they are paying $4 billion a year to take care of those who have retired. What is the answer to that?

Mr. VAN GORKOM. I don't know.

Senator FONG. Those that have not retired at 65, they say they are contributing $4 billion a year to take care of those on retirement, and they say for every year they continue to work, they only get 1 percent, where they should get 12½ percent actuarily.

Mr. VAN GORKOM. That is another problem, and that is the retirement test, and we did make one adjustment to it. It is an extremely complicated problem. I will be glad to talk about it. If you continue to work after 75, and you make more than $2,520, you lose $1 in benefits for every $2 you make above that amount. Those who work beyond 65 complain constantly about this "penalty."

The proper answer, but not an acceptable one in todays world, is that the social security system is intended to replace wages that are lost. If a man can continue to work after he is 65, he really has not lost his wage earnability, and, therefore, he should not get the benefits.

Unfortunately that argument has been compromised, because the system does pay benefits to somebody who could work after 65, but does not choose to. So it is not strictly a case of actually being unable to work, but just not working. The principle was further compromised by permitting persons of 72 or over to make unlimited amounts without loss of benefits.

The Council did recommend that this rule be modestly changed, so that for every $3 earned, only $1 is lost. That reduces the penalty, but what your friend says is true, he still pays a substantial penalty if he earns above $2,520.

On the other hand, he is not correct when he says that all he gets is a 1-percent increase in benefits. There are two other benefits that can be gained by working after age 65. First, you can also increase your basic benefits by increasing your average earnings. You do this by dropping off one of your earlier earning years and substituting one after 65 in which you earned a higher amount. If after 65, you earned $7,000 a year, and back in 1951 you only earned $3,000, you can substitute the $7,000 for the $3,000 and that will increase your basic benefits.

Second, some people are actually able to qualify for the first time under social security by working after they attain age 65. Benefits earned by work after 65 are definitely greater than commonly believed, but of course they do not apply to many persons that do work after 65.

One of the most serious problems is that to eliminate the earnings test entirely would cost a substantial amount of money, about $6 billion per year, if my memory is correct. That is the largest deterrent to eliminating it, and why we did not recommend complete elimination.

Now, on this question of short-term deficits—

Senator FONG. Was any recommendation made to increase the 1 percent annual increment in benefits for those who delay retirement until after 65?

Mr. VAN GORKOM. No. It was recognized, of course, that the 1 percent was inadequate as an actuarial amount.

On the other hand, we do not have any way to quantify these other benefits that can be gained by working after 65 and the one that permits you to drop off an earlier year and substitute one after 65, is a valuable benefit for some people.

THE SHORT-TERM DEFICIT

Now let us discuss the short-term deficit. It arises from different causes. In 1972, Congress enacted the automatic benefit increase, which provided that whenever the cost of living went up, the benefits would go up. At the time they did that, wage increases had been averaging about 5 percent, and price increases, or cost of living, had been going up about 2¾ percent.

Based on these figures, Congress figured, they could increase the benefits on the basis of the cost-of-living rises without increasing the social security tax. Since wages could be expected to increase at a greater rate than the cost of living the additional taxes produced by the wage increases would be enough to pay for the higher benefits. That idea was sound so long as the 4 percent-2 percent or 5 percent-3 percent relationship continued between wages and prices. However, as soon as this relationship became distorted, the principle no longer held. That is exactly what happened. The cost of living went up 12 percent, and wages went up about 7 or 8 percent. The cost of living actually went up faster than wages for a short period and this produced a big drain on the system.

So while the concept was sound when it was introduced, it was based on the continuation of this wage-price relationship, and if this relationship is no longer valid, then it means that you are going to be faced with constantly increasing taxes, because the amount of taxes needed to pay for cost-of-living increases will not be forthcoming.

I would emphasize that we do not expect prices to outrun wages. That is a temporary phenomenon. However, it is not just enough for wages to increase faster than prices. They must increase faster by a substantial amount to avoid increases in the social security tax. It is not just enough to maintain the historical difference of about 2 percent. If the cost of living goes up 10 percent, and wages go up 12 percent, you would still have wages going up faster than the cost of living, but the system would be in serious trouble. There would have to be substantial increases in taxes to maintain the benefit structure at that point.

Wages will have to go up about 70 percent to 100 percent faster than the cost of living if the concept of Congress is to be viable. If that relationship is not soon restored, then you cannot increase benefits by the increase in the cost of living without raising the Social Security tax. If you do not raise taxes the fund will eventually run out.

THE SOCIAL SECURITY "FUND"

When I talk about the "fund," I am talking about the approximately $45 billion that Social Security has on hand.

This is not a fund in the actuarial sense. Social Security is not funded like a private insurance plan and the $46 billion that Social Security has is just a sort of emergency fund to permit payment of benefits even when outgo exceeds income.

This $46 billion that Social Security has at this time is about enough to pay about two-thirds of 1 year's benefits. Because inflation is so high in relation to the increase in wages, the fund is falling as money goes out faster than it is coming in. At the same time the amount of 1 year's benefits keeps going up all the time. The social security fund therefore, is constantly going down not only absolutely but also in relation to 1 year's benefits. It is estimated that by the year 1980 or 1981, as they estimate the trend, there will be no money left in the fund.

In regard to the original question that was submitted to me, I can say that there is no danger in the next 2 or 3 years that anybody will miss his social security payment. There is enough money in here now to make all of those payments, even if this disparity between income and outgo continues for a while.

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There is a danger, of course, that the wage earner will become very concerned over the future of social security by the fact that the fund continues to go down, and particularly because it continues to go down in relation to 1 year's benefits.

The last Social Security Council, our predecessor of 4 years ago, said that this fund should tend to be about 100 percent of 1 year's outgo. There is no magic about that 100 percent, I would have to say, with all due respect to our predecessors, that the system could operate efficiently with something less, but it does not seem wise to reduce it much below 50 percent of 1 year's benefits or it will not be able to protect the system in times of stress.

I think that the amount in the fund should be large enough so that there will be reasonable protection against fairly prolonged recessions, such as we are having now. How big it needs to be, it seems to me, is a question on which people could reasonably differ.

Senator FONG. Are we not eating into that fund by $7 billion a year?

Mr. VAN GORKOM. Not right now, no.

I think the fund itself will go down only about $3 or $4 billion this year. However, the amount of one year's outgo is going up by $3 or $4 billion this year, so that the disparity between the amount in the fund and 1 year's outgo is going up at the rate of about $7 or $8 billion.

Senator FONG. If the cost-of-living allowance is 10 percent, and the outlay is $70 billion, is not $7 billion more eaten into the fund?

Mr. VAN GORKOM. Well, if the cost of living were 10 percent, I cannot say what the deficit would be, but it would certainly be more than $3 or $4 billion. How much more, I don't know, Senator.

Senator FONG. It had been 10 or 11 percent.

Mr. VAN GORKOM. Yes, but you would have to tell me what the wage increases were too. If inflation is 10 percent, then the wage increases are going to be very high, and as the wages go up, more taxes come in, so you cannot work with only one side of the equation. Certainly if nothing is done, if no tax increase is enacted, and we stay where we are, and the forecast of rates of inflation do occur, and the wage increase forecasts do occur, the fund will run out of money by about 1980 or 1981. The answer is that there is no immediate danger in the next couple of years, but there is danger that if nothing is done over the next 4 or 5 years, and the present trends continue, then the system will run out of money. Of course, Congress always has the right to enact whatever legislation it wishes in order to maintain these payments, and I know Congress feels a strong sense of responsibility for the program. So when people ask, I say there is no danger of losing benefits, but you will have to pay higher taxes, or something else will have to be done if this continues for any period. We must face the fact that the whole automatic benefit system, enacted in 1972 by Congress, was predicated on a relationship between wages and prices about which we can no longer feel very confident.

Nobody can tell you with confidence what will happen to wages and prices in the next 20 years, but it begins to appear that there are grounds for believing, that this long-term relationship between wages and prices may be seriously disrupted on a long-term basis. If it is, then there will have to be increases in taxes, or else——

Senator FONG. If the increase in taxes does take place, will it take away from the private pensions?

Mr. VAN GORKOM. Yes, to the extent that many private pensions are geared to social security. When social security goes up, private pensions go down.

Senator CHURCH. Senator Percy, did you want to make a statement?

STATEMENT BY SENATOR CHARLES H. PERCY

Senator PERCY. Yes, I would like to, and I think it might give Mr. Van Gorkom a chance to rest for a moment.

Mr. Chairman, first I would like to welcome, a little late, Mr. Van Gorkom, a very valued constituent of mine, and a man who I was proud to work with within industry, and looked upon as one of the finest and most enlightened businessmen in America. I am just delighted he has seen fit to take on this added responsibility as he has throughout his corporate life, whenever asked.

Mr. Chairman, I appreciate having the opportunity to participate in these hearings on future directions in social security. They will serve as a timely public review of the projections and recommendations of the Social Security Trustees' 1974 report, the report of the Panel on Social Security Financing appointed by the Senate Finance Committee and the report of the Advisory Council on Social Security. Most important, they will serve to heighten public awareness of the exact nature of the financial problems facing the social security system and of the alternative means of dealing with them.

I am pleased that the first witness to appear before this committee is my friend, J. W. Van Gorkom, of Lake Forest, Ill., who chaired the Advisory Council's Subcommittee on Finance.

The Subcommittee's report is both comprehensive and of invaluable assistance to the Congress in adopting improvements in the social security system. The Subcommittee had a short period of time in which to complete this difficult work, and I commend Mr. Van Gorkom and the other Subcommittee members.

I have been aghast at the verbal battle waged during the last few months over the financial soundness of the social security system. Now that two panels of experts have confirmed the projection of financial problems made by the OASDI Board of Trustees in its 1974 report, hopefully we can rise above the din and work together to bring order to this system.

It is as fiscally irresponsible and cruel to the elderly to ignore reality and leave these problems to future generations as it is to declare that the system will soon collapse and do nothing to prevent it.

The social security system will not collapse. Future generations will not deny earned benefits to the retired. However, it is evident that the system cannot continue to be self supporting under the present contribution and benefit formulas. The immediate gap between income and outgo is small compared with the deficit projected for the twenty-first century. We must avoid the temptation to deal with the short-term problem with stop-gap measures and leave long-term solutions to those who will be responsible for the system at that time. To do so could not help but result in serious economic dislocations and hardship.

Fair and Sound Program

Two main factors must be taken into consideration in redesigning the social security system. Its economic impact must be fair and manageable for employers and workers on the one hand and fair and adequate for retirees on the other. It must also be financially sound over the long term, so that neither a massive infusion of funds nor a reduction in benefits is ever necessary. If we take corrective action now, I believe it is possible to meet both these goals.

The Social Security Advisory Council estimates that by 1978 the balance in the trust fund will be under 35 percent and that this is about the minimum balance necessary to fund current obligations. By 1980, tax receipts will once again approximate expenditures. After 1980, costs are projected to rise dramatically, and by the year 2030 would necessitate a payroll tax of 17.6 percent to fund them. These are very close to the estimates provided in the 1974 Trustee's Report. The Panel on Social Security Financing appointed by the Senate Finance Committee projects a similar short-term deficit, but estimates that costs will reach 23.3 percent of taxable payroll by the year 2030.

The difference in estimates stems from the different economic and demographic assumptions used by each panel. The Advisory Council estimates an average increase of 5 percent in wages, and 3 percent in the Consumer Price Index over the next 75 years, and an increase in the fertility rate—the average number of children born to a woman during her lifetime—from 1.9 to 2.1 beginning in 1985.

These are essentially the estimates used by the Trustees. The Finance Committee's Panel assumed an average increase of 6 percent in wages and 4 percent in the Consumer Price Index and a dip in the fertility rate through 1990, with the 2.1-percent rate not being reached until the year 2025.

Obviously, relatively small differences in economic and demographic assumptions lead to significant variations in estimating the long-term financial soundness of the social security system. In adopting corrective measures, it is important to keep the lack of long-term predictability of these vital factors in mind. For example, it may be reasonable to presume an even greater degree of labor force participation in the next century then did either the Finance Committee Panel or the Advisory Council. As there are fewer and fewer workers relative to consumers, unemployment will drop and a greater number of women and potential retirees will join or remain in the work force.

I believe the most sensible course at this time is for the Congress to enact those changes in the social security system which will assure its enduring effectiveness. Adoption of some of the Advisory Council's recommendations, as well as other proposals I intend to make, could stabilize the system's financial base through the remainder of this century. By 1990 we will know for certain the ratio between workers and retirees during the first half of the 21st century, the most important variable in today's cost projections, and will be able to plan ahead accordingly. This, of course, assumes that there will be no changes in the present system which significantly increase benefits relative to payroll taxes.

First, and I believe most important, is the recommendation made by both the Social Security Advisory Council and the Panel on Social Security Financing to decouple social security benefit levels. Under the present system, a worker who retires 20 years from now will receive a social security benefit which will directly reflect not only the compounded 20-year increase in the CPI but all wage increases received during the period.

Estimated Long-Term Deficit

For a worker retiring in the year 2050, this could result in a monthly social security benefit 60 percent higher than the worker's average preretirement wage. Coupled with a wife's or husband's benefit, the retired couple's benefit would be nearly 150 percent higher than the worker's average preretirement wage. While this problem is not critical to the financial integrity of the system today, it plays a major part in the estimated long-term deficit. Decoupling the system by basing retirement benefits on a worker's average monthly wage, increased, or "indexed," to reflect average wage increases for all workers during that period, and providing cost-of-living increases only after retirement, will correct this problem. The Advisory Council estimates that this change alone will reduce the estimated average long-term deficit by nearly one-third.

Second, in line with insuring that benefits bear a reasonable relationship to preretirement earnings, total benefits should not exceed the purchasing power of preretirement earnings. A maximum replacement ratio of 80 to 85 percent of average "indexed" preretirement earnings would be both fair and adequate.

Although these changes would result in a cost savings under the economic assumptions used by both the Advisory Council and the Finance Committee Panel, it is important to note that they could increase costs if real wages increase at a higher rate than projected. The importance of these changes rests in the fact that they will bring the revenues and costs of the system closer in line, whatever the long-term relationship of wages to prices turns out to be.

Third, I believe the automatic eligibility of wives to a "dependent's" benefit equal to half their husband's benefit should be phased out and that this benefit be paid only where actual dependency exists. This automatic eligibility was enacted on the presumption that wives are almost invariably dependent on their husbands for more than half their income. More and more women are now collecting social security and other pension benefits based on their own earnings and this presumption is certainly no longer valid. It is unfair to those men and women who contribute to the social security system to have to pay the costs of "dependent's" benefits to individuals who are not in actuality dependents.

The Advisory Council recommended doing away with the proof of dependency now required of husbands applying for such benefits and in the alternative, decreasing both husband's and wife's benefits by the amount of any pension earned from earnings not covered by social security.

A far simpler and more equitable solution is to require actual dependency for both men and women.

Fourth, consideration should be given to the establishment of a special replacement ratio for retirees who have spent relatively little of their work careers under the social security system. The Advisory Council spent considerable time looking into the inequity of such workers benefiting from the higher earnings replacement ratio for those with a low average preretirement wage. The higher replacement ratio was enacted, of course, to provide an adequate retirement income for those who worked for many years under social security but at low wages. One solution recommended by the Council was to reduce social security benefits by the amount of any pension or benefit earned from employment not covered by the social security system.

I do not believe it is fair to penalize such workers, Government employees being a major example, for working in noncovered employment. An alternative approach would be to establish a separate schedule of replacement ratios for workers who contributed to the social security system for less than 10 or 15 years. Such workers would then receive a fair return on their contributions to the system but would not benefit inequitably from an elevated ratio established for low income individuals.

Of course, any changes adopted in the system should not adversely affect those already retired or the long-term retirement plans of workers. Thus, the first two proposals I have outlined should become effective immediately, but only as to future retirees, and the second two should be phased in over a period of years.

If Necessary, Accelerate Scheduled Tax Increases

Finally, if these proposals are not adequate to eliminate the projected deficit over the next 25 years, consideration should be given to moving a portion of the tax rate increase scheduled for the year 2011 forward to the 1990's and/or accelerating the scheduled increases in the taxable wage base. I do not believe the tax rate should be increased beyond the rate of 11.9 percent now scheduled for 2011. Including the 1.8-percent medicare tax, this will amount to a payroll tax of 6.85 percent each on employers and employees. This in itself will be a fairly substantial burden, particularly for low-income workers and small businesses, and I do not believe additional increases should be counted on to finance whatever long-term deficit may develop.

Certainly, a thorough study should be made of the effect of the payroll tax on the adequacy of capital investment and workers' purchasing power before any additional changes in the rates are made.

I must also disagree with the Advisory Council's recommendation of gradually transferring the financing of the medicare program to general revenues and using the revenues from the medicare payroll tax to help finance social security benefits. Although I appreciate the Council's interest in postponing any increase in the payroll tax, I believe further consideration should be given to the effect of this proposal on the medicare program itself. It, like social security, is an earned benefit, and should continue to be so. In addition, we have yet to determine what place the medicare program will have in national health insurance and should make that determination before enacting major changes in its financing structure.

In conclusion, if we act now, the short-term financing problems of the social security system can be solved without economic dislocation or hardship and we can lay the basis for an equitable and potentially fiscally sound system in the future.

These hearings and the recommendations stemming from them can lay the basis for such action. I have three specific questions, but I will be happy to wait and yield to others, and ask those questions when it is my appropriate turn.

Senator CHURCH. Thank you. Senator Moss, would you like to make a statement?

STATEMENT BY SENATOR FRANK E. MOSS

Senator MOSS. Thank you, Mr. Chairman. I did not come prepared with an opening statement, but I am, of course, intensely interested in this general problem, and as the chairman has indicated, and Senator Percy, with whom I have worked so closely, there is a great deal of feeling for our elderly people, and there exists much uneasiness among our elderly because of the constant cropping up of this suggestion that the social security fund is inadequate, and some even coming in to say it is already broke. I was pleased to be here long enough to see some of your presentation, and I look forward to your finishing it, because without as much information about it as you have, I always write back, or speak back, saying, no, no, the funds surely are not in trouble now, and long before that date comes, you can depend on the Congress taking action.

I point out we are in such an economic period of shift, with prices and wages, and all other things going up at a tremendous rate, that we do have to reexamine the whole structure, and look at it, but there is time to do that. If we now address ourselves to the problem there need not be any worry that we will not have enough time, in that the social security program will not be able to meet its obligation to the elderly.

The difference now between the President's proposal, and the statutory requirement of the increases, are just a minor thing, and they will be ironed out, but the long-range problem is the one we must be concerned about, so I am very pleased you are here, sir, and the other good witnesses coming on. Thank you.

Senator CHURCH. Thank you very much, Senator Moss. Mr. Van Gorkom, we are looking at the clock. We are moving toward 12, and we have two more witnesses.

I believe I have asked you the questions in the course of your presentation that I want to put to you this morning, but Senator Percy has indicated he has questions, why don't we go to those questions.

EFFECT OF PAYROLL CONTRIBUTION ON BUSINESS

Senator PERCY. Mine are very brief. Mr. Van Gorkom, you and I have traveled in the same business community. I do not know of a subject that is of greater concern to some of our industrial friends in Chicago than the social security tax. They look upon this as an imposition of a tax that adds to their cost of doing business; it makes them somewhat less competitive to products abroad, because they have this added as a cost of their product. From your perspective as a businessman and employer, could you comment on the economic effect of the

Council's recommendation that the social security payroll tax be increased gradually to 16.1 percent by the year 2025, this in addition to the 1.8 percent medicare tax?

If that is still in effect, if not higher, it will result in a tax of 8.95 percent each on employers and employees, about a 50-percent increase from present levels.

Would you care to comment on the economic effects of that?

Mr. VAN GORKOM. Well, when you talk about the economic effects, I think you will find, Senator, that the economists are strongly of the opinion that the social security tax is really imposed on employees.

Now, with the one exception you mentioned, the social security is neutral as a competitive factor, since it is uniform for all companies. In the case of my company competing with another company, we both pay the same social security taxes, so there is no competitive disadvantage. But as to its real impact on U.S. companies competing overseas, I do not have any data. I strongly suspect, however, that the social taxes imposed by overseas companies, is probably equal to or greater than the taxes we pay in the United States.

Furthermore, I strongly support the social security system. I think it has served this country well, and my basic concern is for its maintenance in the future.

I think the most important thing the Congress has to remember is this: When they passed the automatic escalation law in 1972, they made a very fundamental change in the whole social security system, the extent of which was not realized because we were living in a time when we had a fairly stable relationship between prices and wages. The premise needs to be reexamined. If you want to maintain the present benefit structure, and given the most recent forecast of wages and prices, we will have taxes of 16 percent and higher.

Senator PERCY. This is not a typical audience in this room. I would imagine in our audience there are representatives from Government agencies who are here to hear your testimony firsthand, and up here, most of us are Government employees, so most of the people in this room are not covered by the social security system.

The Council has recommended compulsory coverage of Government employees, as well as reducing social security benefits by the amount of the benefit received from noncovered employment. I am concerned this would establish a means test for a selected group of social security recipients, and would unfairly penalize those who work in noncovered employment.

As an alternative, what is your opinion on establishing a separate replacement ratio for those who contributed to the social security system for less than 10 or 15 years?

THE "WINDFALL" PROBLEM

Mr. VAN GORKOM. Well, I would have to comment on the whole problem. The Council spent quite a bit of time debating what we call the windfall problem. People who work under the Federal Government and State government can accumulate substantial pensions, and in the latter part of their careers they can shift to a job covered by social security and earn another pension from the social security system. Under the present system you cannot distinguish between such people and the people who have worked all their lives under social security at low wages. The government people get a windfall, because if they had continued to work under the Federal Government their wages in their late years would earn a pension based at about 50 or 60 percent of their wages. But if they shift to work covered by social security their work earns a pension at 120 percent of their wages. This 120 percent is intended for people who worked for low wages, as I have explained earlier. Instead the 120 percent is applied to those with high wages who appear to have low wages because they only work a few years.

What Senator Percy has proposed is a way to try to solve this. The Council wrestled with that problem for a long time, Senator, and we were unable to come up with a plan that would do it exactly right without hurting somebody else in the system.

We thought we could do it rather simply at first, but the system is so complex that every time we came up with an idea, the people in the administration would point out that some other group would be unfairly treated. We finally decided that the only real way to solve the problem is to have compulsory total coverage, and that is the reason it has been recommended.

Senator PERCY. I did not realize that windfall benefit, and having been one of those who used to pay social security taxes, and worked, and now not under that system, is there any plan to make this retroactive, so those of us who are going to get apparently a windfall would not get it?

Mr. VAN GORKOM. I have to add a point. You will note that we recommend in our report that coverage be universal, but in computing what the tax rate should be, we have assumed there will not be universal coverage, because we do not think there is any enthusiasm on the part of Government employees to be covered by social security, and we do not think, therefore, that Congress will adopt it. But we felt it was a very desirable goal.

DEPENDENCE BENEFITS

Senator PERCY. My last question relates to the Council's recommendation to remove the support test for husband's eligibility for dependence benefits, and continuing presumption of eligibility for wives.

I wonder if it would not be more equitable to eventually require proof of dependence in either case. It seems unfair to those men and women who contribute to the system to have to pay the cost of dependents' benefits to individuals who are not in actual dependence.

It would be helpful if you could go into the reasoning of the Council in adopting the recommendations in this area.

Mr. VAN GORKOM. We did consider that, and we do think that is probably the more fair way to do it, but we also are pragmatic.

Peculiarly, this whole thing, to take away the dependency proof required, came out of a committee designed to help women. They studied all parts of the system that appeared to discriminate on the basis of sex, and that turned out to be the only one we felt we could accommodate.

It would be fairer to require women to prove dependency, but we simply felt it would be impossible to get women to accept the burden of providing dependency. We also felt that, whether we willed it or not, discrimination of this type, based on sex, will be eliminated by either Congress or the courts. It was decided, therefore, to eliminate it by putting both persons on the same parity. We put men on the same platform as the women simply because we did not think the women would accept the men's situation. It was a purely pragmatic solution.

Senator CHURCH. Senator Fong.

Senator FONG. I have quite a few additional questions here, but I would like to ask Mr. Van Gorkom to give me the answers in writing for the record.

Mr. VAN GORKOM. I would be glad to.

[The following were Senator Fong's questions and Mr. Van Gorkom's answers as submitted subsequent to the hearing:]

Question. When did the Advisory Council on Social Security first meet?

Answer. Appointment of this Advisory Council was announced by the Secretary of Health, Education, and Welfare in April, 1974 and the first 2-day meeting was held the following May 3 and 4.

Question. How many times did it meet? How many days were devoted to deliberations by the full Council?

Answer. There were nine 2-day meetings of the entire Council.

Question. What were the special subcommittees named by the Advisory Council? Responsibilities of each?

Answer. There were two subcommittees. One was on financing of the Social Security program and dealt with assumptions and methodology used by the Office of the Actuary of the Social Security Administration. The second Subcommittee was appointed to study the treatment of men and women under social security with respect to sex and marital status. A Task Force of four Council members was also named to examine the adequacy and equity of social security.

Question. How many times did each subcommittee meet and for how long?

Answer. The Finance Subcommittee met 10 times, the Subcommittee on men and women seven times, with each meeting lasting several hours. The Task Force met six times, for a total of 12 hours.

Question. How was the Advisory Council staffed?

Answer. The Advisory Council was staffed by the Social Security Administration and coordinated by its office of Program. Evaluation, and Planning with staff member John Trout serving as executive secretary. Some members of the Council provided their own secretarial staff.

Question. What did the consultants to the Council do with reference to Council deliberations?

Answer. The consultants provided the technical expertise in handling the actuarial and economic problems with which the committees had to deal. They did not sit in on the deliberations, except in a few instances, especially the last meeting or so. They did not participate unless they were asked questions by Council members. Their major contribution was through reports which they wrote.

Question. Was the idea of using regular consultants from outside of government a new departure by this Council from practice of previous Advisory Councils on Social Security? How were the consultants selected?

Answer. Consultants have been used by previous Councils. Consultants were selected by the Chairman and vice-chairman. Their names were placed in nomination, and approved, without objection by the Council. For the first time, two consultants were hired as generalists, one as assistant to the chairman, one as general assistant to the vice-chairman. Other consultants were hired for their expertise in finance and on the basis of their general reputation.

Question. In its report, the Social Security Advisory Council recommended that "a general study of social security should be made by a full-time nongovernmental body, covering such matters as funding versus pay-as-you-go, possible effects of social security on capital formation, productivity, the proper size of the trust funds, the incidence of payroll taxes, and other basic questions." Do you personally share this opinion by the Council?

Answer. I certainly do share the Council's reasoning in making this recommendation.

Question. What was the Council's reasoning in making this recommendation? Was it based on recognition of the inadequacies in any short-term review? Did the Council's view reflect frustrations of Council members in your deliberations?

Answer. This particular Council was very conscious of the fact that it simply did not have sufficient time to adequately review the broad questions covered in the recommendation. Those matters are very essential to a proper understanding of the system and there are others which could probably be added to the list. We do not have any specific idea as to how the reviewing body should be created or the term it should serve. Our basic conviction was that 1 year, or even 2 years, was not adequate to really probe in depth the basic principles which underlie the entire system. These elements are so complex that they require far more time than an advisory council can normally apply. We simply feel that the questions are so important that a first-class group should be given whatever time is necessary to come up with definite answers.

Question. What were the reasons for specifying a "nongovernmental" review body? Do you think the key in the "nongovernmental" element was a feeling that independence from the Social Security Administration and HEW, is important?

Answer. The Council was very well impressed with the ability of the Social Security Administration, but it felt that the kind of deliberation and analysis with which the proposed body would be involved were not such that they could be handled by people charged with day-to-day administrative responsibilities. While it probably would not be improper to have a representative of government in the group, it certainly should be a very broadly representative group because of the very broad nature of the questions to be involved.

Senator FONG. You met once in 4 years, did you not?

Mr. VAN GORKOM. Yes.

Senator FONG. And then a new Council comes in?

Mr. VAN GORKOM. Yes.

Senator FONG. Now, don't you think we should have a National Social Security Commission that will work full time? Because you have given us many problems, which you have not been able to solve, and that are so complex and affect so many people, don't you think we should have a Commission that should be on the job, working at this, independent of HEW?

Mr. VAN GORKOM. Certainly the Council felt very strongly, after beating their brains out literally for 9 months over the problems, that the system is so important and so complicated that such an approach is not really a satisfactory way to do it.

There are some basic long-range problems that need to be attacked by some group. I will not attempt to say what group, but it does need a group of people who can devote time over a much longer period and who can get the necessary experts to work with them. There are some very broad problems, such as what is the effect of a social security system on capital formation.

Where does the tax really fall? Does the employer's part of the tax fall on the employee?

I could not agree with you more, Senator, and we are convinced that the problem is so complex, and the system so important to the country, that some kind of continuing devotion of effort by competent people should be arranged. I don't think it necessarily needs to be full-time people, but to put together a new Council every 4 years is not enough, and particularly when we are given only 9 months to do the job.

Even 2 years is not enough. I think you have to have people dedicated to it long enough so they understand the problems.

Senator FONG. I introduced Joint Resolution 5,* which calls for appointment of nine members to serve on a full-time basis.

Senator MOSS. The one question I wanted to pose is that many economists say that social security taxes are very regressive, and for that reason, should be altered. Did you deal with this in your report?

Mr. VAN GORKOM. Yes; we dealt with it in one sense.

The social security tax is not really as regressive as it seems to be. The tax rate is uniform to high- and low-paid people, but the benefits are not uniform. They are weighted heavily in favor of the low-paid persons, so it is less regressive in its total effects than it appears to be. I have stressed the importance of the relationship between wages and benefits and the sense of responsibility this induces in the employee-taxpayer. If the system becomes too "progressive," you run the risk of distorting this relationship to the point where the sense of responsibility is lost. You approach the same problem when you introduce general revenues. I think there is a fine line to be drawn, and reasonable men could certainly differ here. Certainly the tax is not nearly so regressive as people imagine.

Senator, I want to make this one statement, and that is, I want to close with a brief word of praise for the people we worked with in the Social Security Administration.

Here is a system that sent out over 30 million checks a year, and as a businessman, I can appreciate what that involves. They also keep records on over 90 million people, and yet they do all this with an administrative cost of less than 3 percent.

The people we met were hard working, knew their job, were dedicated, and they must be, or they could never hold those costs down that far.

Senator CHURCH. I think you have given us excellent testimony today. I want to express my appreciation and that of the committee for your appearance.

Mr. VAN GORKOM. Thank you.

Senator CHURCH. Our next witnesses are Mr. J. Henry Smith, chairman of the board, Equitable Life Assurance Society of the United States, and Mr. Rudolph T. Danstedt, assistant to the president of the National Council of Senior Citizens.

Senator Williams hoped to be here. He hoped to make it before your testimony ends and he wanted me to convey his regards to you in the event he could not be present.

Mr. Smith, you have a prepared statement? Do you wish to read that? Would you like to summarize it? You can proceed as you wish.

STATEMENT OF J. HENRY SMITH, CHAIRMAN OF THE BOARD, EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES

Mr. SMITH. I do have a prepared statement. I must say, we are following a very tough act. Mr. Van Gorkom's testimony was expertly done indeed and in his comprehensive development of the questions, he has covered a great deal of the testimony I might have given or is included in my prepared remarks.

I think I can save you some time, if you wish, by hitting some of the high spots of my testimony.

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*See appendix 1, p. 859.

Senator CHURCH. That will be fine, and we will include your full statement in the record.*

Mr. SMITH. I have stood in Mr. Van Gorkom's shadow now for some time. He has been chairman of the subcommittee on which I served. I must say he has done an extraordinary, a wonderful job; and I congratulate him for his testimony here today.

There were three specific questions I was asked to cover, but before going into that, I would like to say that although I filed some of the demurs, I do not consider myself a dissident member of the Advisory Council.

I agree with most of its recommendations. I think in the time it had, and considering the magnitude of the questions and their diversity, the Council turned out a good job.

The principal question I am asked to cover is to give a summary of my reasons for opposing the majority recommendations of the Advisory Council, for a gradual reallocation of the contributions from part A of the medicare system to the OASDI cash benefit program, with the expectations that general revenues would become the sole source of funding for the hospital insurance program.

My contrary views in this recommendation, along with those of three other Council members, appear in a special statement on page 91 of the Council's report. I will summarize them briefly here.

SHIFT OF RESPONSIBILITY

Basically I do not believe this particular recommendation is a real solution to the funding problems faced by our social insurance complex. It just shifts the deficit from one social insurance plan to another, without solving the basic problem of underfunding.

I think it is wrong because first of all, it assumes that the Treasury is an easy source of funds, which I guess is a questionable assumption at best today.

Second, it makes a serious retreat from the principle of payroll financing which the Council has endorsed as appropriate to social insurance systems.

Third, the additional expenditures from general revenue, which would be required for medicare, unless financed by new taxes, will contribute further to inflation.

Fourth, general revenue financing would tend to mask the true costs of the program and weaken further the control over it; and finally, it would turn medicare into a kind of welfare program, which probably would involve a means test.

I cannot accept Mr. Van Gorkom's argument that medicare's status as a social insurance system would not be jeopardized.

I agree with the chairman's concern, as you expressed, that changing medicare to general revenue financing would tend to make it into a welfare program.

There are some more arguments in my prepared statement in this respect but perhaps it is enough to say, as Mr. Van Gorkom has argued quite persuasively, I think, we should not resort to general revenue financing for the cash revenue system. I thoroughly agree with him

*See p. 848.

but I think his cogent arguments apply to the medicare program as well as to the OASDI program.

This reduces us to taxes, just as the Council's recommendations would do with respect to medicare benefits. Regrettable as increased taxes may be, I think we should maintain the integrity of the system by calling in the near future for modest increases in OASDI contributions, just as we have done in the past and just as the system has been expected to do in the future.

A small increase, about a half of 1 percent for employers and employees would be adequate for several years. It would be a reasonable price to pay for the rapidly increasing benefits that are provided.

Again, I will skip along. The second question I was asked had to do with the function of the social security trust fund and I think Mr. Van Gorkom has adequately covered that. I will skip that part of my presentation, if you will agree.

The next question was: Do I have any fears about the soundness of the social security system and my answer to that is "No." This has been covered by others lately, and I will refer you to the backup arguments in this presentation, if you are agreeable. I do not think the system is bankrupt and I think if Congress will take the necessary steps, as I am sure it will do, in the long run, our three-tiered system can be perpetuated soundly and with full satisfaction.

Three-Tiered System

Now, this reference to the three-tiered system leads to what should be the relationship between social security and private pensions.

Again and again, as Mr. Van Gorkom has stated, the design of the income maintenance system appropriate for this country has been described as consisting of three tiers. Mr. Van Gorkom again outlined this at some length, the bottom tier being welfare arrangements, the middle tier being social security, OASDI system, and the upper tier being private enterprise savings, insurance, pension plans, et cetera.

This is the concept that I would stress in answering the question of the relationship between social insurance and private pensions.

I have a page and a half of discussion of this but I really think, in the circumstances, it might not be necessary to repeat it now. I believe Mr. Van Gorkom laid the foundation for all of the argument that is needed.

I will be glad to go further into it if you wish; but in the interests of time, I would suggest that if you have any questions I could answer, I will be glad to.

Senator Church. Thank you very much, Mr. Smith. Your prepared statement will be entered in the record at this time.

PREPARED STATEMENT OF J. HENRY SMITH

My name is J. Henry Smith. I am the chairman of the board and chief executive officer of The Equitable Life Assurance Society of the United States. I appear here, however, primarily as a member of the latest Social Security Advisory Council which recently rendered its report.

Because of the importance of the work of your special committee, I am pleased to have been asked to appear before you, hoping to respond helpfully to the questions you have addressed to me and to any others you might see fit to ask me.

Before coming to the specific questions, however, I would like to say that I do not consider myself a dissident member of the Advisory Council. I agree with much of what the Council has recommended. I think the Council has made constructive recommendations, including especially the plan to change the OASDI benefit calculation so as to stabilize the replacement ratios (i.e. the ratio of primary benefit to earnings in the year immediately preceding retirement). This particular change is needed in order to make the system more rational and equitable, less erratic in its results; and to introduce badly needed stabilization of costs. It is also important in overall retirement planning and integrating of private and public pension programs. All in all, I think the Council turned out a commendable product, considering the short time period available to it.

Now for the questions. Your first one asks that I give a summary of my reasons for opposing the majority recommendation of the Advisory Council for a gradual reallocation of the contributions for part A of Medicare to the OASDI cash benefits program, with general revenues becoming the sole source of funding of the Medicare hospital insurance program.

My views on that recommendation, along with that of three other Council members, appear in a special statement on page 91 of the Council's Report. I will try to summarize them for you here.

Shift of Responsibility

First of all, I do not believe that this particular recommendation is a real solution to the funding problems faced by our social insurance complex. It just shifts the deficit from one social insurance plan to another without solving the basic problem of underfunding. It is wrong because: (1) It assumes that the Treasury is an easy source of funds, a questionable assumption at best today; (2) it marks a serious retreat from the principle of payroll financing which the Council has endorsed as appropriate to social insurance systems; (3) the additional expenditures from general revenues, unless financed by new taxes, will contribute further to inflation; (4) general revenue financing would tend to mask the true cost of the program and weaken even further the control over it; and (5) it would turn Medicare into a kind of welfare program, which perhaps should involve a means test.

To argue that Medicare benefits are not wage-related and, therefore, it is appropriate to support them by general revenues is more a rationalization than a principle. There is no more valid reason today for funding Medicare from general revenues than there was initially. Medicare is now looked upon truly as a social insurance program, and it is just as desirable to support it with joint employer-worker contributions as it is for OASDI.

Regrettable as increased taxes may be, I think we should maintain the integrity of the system by calling in the near future for increased OASDI contributions, just as we have done in the past. A small increase—about a half percent for employees and employer each—would be adequate for several years. It would be a reasonable price to pay for the rapidly increasing benefits provided. It is likely that in the long-run, future increases in cost of the system will require additional taxation, and we might as well continue to exercise the discipline of balancing benefits and taxes as we have in the past. This is the only way to preserve the philosophy, the integrity and the general understanding and acceptance of the system.

Your second question asks: What do I perceive as the primary function of the Social Security trust fund? Before answering that question, let us note that OASDI system is financed on a "current cost method." There is no advance funding as we know it in a private insurance system. Instead there is a current intergenerational transfer of funds. The social security contributions of workers become the benefits paid to those retired. For those now working, benefits payable when they retire will be met by the following generation of covered workers. While this is not a sound method for private pension plan financing, it is a sound (and the only feasible) alternative for OASDI because the system is compulsory and universal and the government has the continuing power to collect the funds needed to pay future benefits.

Consequently, whatever trust fund is maintained is needed only to smooth out the differences between a fairly evenly rising expenditure level and an income that is subject to seasonal, cyclical and even institutional variations. That is the primary function of the trust fund. There is no controlling theory dictating the size of the fund, but it should be large enough to smooth out variations and to meet the effect of contingencies such as an extended recession or period of high unemployment.

It is a matter of judgment, but I concur in the widely held view (put forward by at least one previous Advisory Council) that it would be desirable to aim in the longer reach for a reserve somewhere between 75 percent and 125 percent of 1 year's benefit payments. The current fund is less than that, being in the neighborhood of 67 percent. That seems low to me, but not dangerously so. It is still adequate to meet the deficiencies which are at all likely to occur in the near future. In view of current conditions, I go along with the Council's recommendation that the fund should be stabilized at about 55 percent of 1 year's outgo until 1980; and thereafter have it raised very gradually to 100 percent.

The next question is, do I personally have any fears about the soundness of the Social Security system? My response is "No", so long as benefits are kept to reasonable levels, because I believe Congress will always call for contributions to the plan adequate to support benefits. Let me state here and now that the scare stories that have appeared in many newspapers around the country to the effect that the Social Security system is going broke are much overdone. They do not give credit to the resilience of the system. It is not bankrupt; the difficulties we face are not insurmountable and they do permit sufficient time for correction. However, I would hope that, in taking the necessary corrective steps, the Congress would continue to display the wisdom it has shown in the past by stressing strict adherence to the fundamental principle that OASDI should remain a benefit-earnings related program with boundaries appropriate to the principles of the three tiered system.

THREE-TIERED SYSTEM

This last reference to three tiers leads to my response to the last question, which asks, what should be the relationship between social security and private pensions?

Again and again the design of the income maintenance system appropriate for this country has been described as consisting of three tiers. As our Council reiterated, the OASDI plan is, and should continue to be, the primary means of providing basic economic security in the event of retirement, disability or death of workers. Thus it is the core of the nation's total system of income protection. It is the central layer, however, because it is undergirded by means-tested welfare programs; and it is supplemented by private efforts, group and individual, essential to fulfill the needs and desires for protection above and beyond the floor of protection provided through the social security program. That program was introduced originally for the principal purpose of preventing workers and their dependents slipping into poverty and hardship and that should continue to be its rationale, and its dimensions should be drawn accordingly.

In this concept, private pension plans and individual thrift arrangements have an opportunity to build on the basic protection provided by the government system in order to help people and organizations provide desirable income levels that would give them reasonable comfort and standards of living appropriate to their earnings levels during active employment.

Thus it may be said that there is a partnership between the government and the institution of private thrift which I believe entails some obligations both ways. The government, that is the people, have the right to expect certain considerations and actions from the private sector. It can expect us in that sector to work hard to broaden our coverage and increase the adequacy of our offerings; it can expect better cost and quality controls; it can expect us to be responsive to needs (e.g., with regard to adequacy and vesting of benefits); it can expect us to be innovative and constructive in the interest of our citizens; and lastly it can legitimately expect the private sector to accept change when change is warranted.

And as to its role in the partnership, we hope that government will rely on us to carry out our part of the bargain; that it will hold high the encouragement of private thrift; and that it will avoid disabling legislation and will restrict the operation of the social security sector so that it does not unduly invade the private sector's sphere of operation.

It is my belief that with the new pension legislation recently enacted, the partnership I visualize is a going one with sound purposes and high potential.

I think I can speak with considerable assurance that we in the private sector will vigorously prosecute our job to see that healthy, effective and adequate growing private benefit systems will do their part.

There is one other point of great importance to be made as to private pension plans. To be soundly financed, they require (unlike social security) the accumulation of large dedicated funds. These funds must be invested and they become the source of much of the capital needed in this country for the nourishment and expansion of our industries and commerce. In the capital hungry days we are most likely to encounter in the future, this mechanism for supplying greatly needed financing will be of great value to the economy.

Senator CHURCH. Before we go to questions, I wonder if we might not hear from our other witness, Mr. Danstedt?

I understand, Mr. Danstedt, that like Mr. Smith, you take some exceptions to some of the recommendations of the Council and I wonder if, in the interest of time, you could emphasize those exceptions. Your entire prepared statement will be included in the record.*

STATEMENT OF RUDOLPH T. DANSTEDT, ASSISTANT TO THE PRESIDENT OF THE NATIONAL COUNCIL OF SENIOR CITIZENS

Mr. DANSTEDT. Yes; I think I can. I was also a member of the financial committee, of which Mr. Van Gorkom was chairman, to whom I also pay tribute, as Mr. Smith.

On the other hand, I did not only file a supplementary statement but a dissent and I think part of that dissent was related to the process engaged by the Advisory Council.

After all, we really did not get down to dealing with financial proposals until the next to the last of the 2-day meetings. It takes time to get oriented. We did not have enough time, we had only 9 months, in contrast to the 18 months of the 1970–71 Council.

Actually, we could, under the law, have been appointed back in 1973, if Mr. Weinberger had got going and done something about it, so we could have had a good deal more time on our hands but we found ourselves with only two 2-day meetings available to discuss finance and then we came out first with a proposal for a $24.000 wage base and an increase in the tax rate, to take care of both the shortrun and the long-range costs.

There was a minority of us who favored raising the wage base but insisted we could not impose any more taxes on the employee group and insisted that the time had come for us to begin going gradually into the use of the general revenues.

We lost out on this, however. The majority did approve a $24,000 wage base and increase in the tax rate. On the last 2 days of meetings we found ourselves in a position whereby, for all practical purposes, we rescinded the action taken at the previous meeting of the Council and wound up on a late Saturday of the last two meetings with no plan for financing. Then we found ourselves engaging in an informal meeting of the Council and running what I call a shell game, pushing the shells around. We lifted one up and found a pea that constituted hospital insurance contributions and decided that was the way we could take care of the deficit.

Now, again this morning, when I heard Mr. Van Gorkom's presentation, I wish we could have found another set of meetings to discuss

*See p. 853.

more fully, the implications of the action that was proposed. We never discussed adequately the use of the general revenues but we found ourselves pushed, in this last session, into making a decision in which we do take the hospital contributions and use them to finance the deficits in the OASDI program. My dissent is substantially related to the process in which we engaged.

Now, as I say, I could go on and develop a lot more fully why I felt this strongly about the action taken. I put in a lot of time and effort, a lot of consultation and decided I not only had an obligation to object to this process which Mr. Van Gorkom admits and I think anybody you want to talk to agrees, it can only eventually reduce medicare to medicaid.

There is bound to be a means test of some sort applied, when you begin to introduce general revenues in the hospital insurance program.

An Alternate Approach

I felt I had an obligation also to try to suggest another approach and this is contained in my presentation and it is relatively simple. It increases first the wage base, maybe $24.000, moving gradually up over a period of time to maybe as much as $28,000, which by the way was also enforced by the AFL-CIO executive council at its meeting in February.

Second, I think there should be a tax on the employer's full payroll; third, with the increase in the wage base, the insurance program would be overfinanced and we would take the 0.2 percent tax on employee and employer that goes in effect in 1978 and shift that over to the cash side of the picture. My final recommendation is to restore to the Social Security Act the authority to appropriate to the trust funds moneys from the general revenues.

Under this formulation I developed, we would come out with a plan that would enable us to move well into the late 1980's—with the increase in the wage base, the shift of this small health insurance increase over to the cash benefit side of the picture and then maybe in the latter part of the century, we would have to move gradually into the use of general revenues.

I was intrigued when, at the Council's press conference on Friday morning, Mr. Weinberger, to whom we were reporting, failed to appear. However, his presence was felt in terms of the statement he put out, in which he objected to the use of the general revenues for financing the medicare part of the social security. Then on the same day the President also voiced a similar objection. Thus from the standpoint of where the votes count and from the standpoint of the persons to whom we made this report, the Council struck out with respect to how the system should be financed in the period ahead.

If we had the time today, I would enjoy getting into a discussion on raising the wage base—what it really does—in terms of the fact that it does not affect capital formation, does not affect ability of the people to purchase annuities. I particularly want to emphasize that probably less than a third of the people under social security have any kind of annuities. The Council report talks about our income protection system—SSI which is a means test. Social security, and private annuities available only to a favored minority.

Private pension arrangements are available only to about one-third of the people on social security and it will be years before even half of the social security recipients will be covered by private pensions.

The only solid income protection system we have is the social security system. This I have emphasized in my dissent.

Senator CHURCH. Thank you very much, Mr. Danstedt. Your prepared statement will now be inserted in the record.

[The prepared statement follows:]

PREPARED STATEMENT OF RUDOLPH T. DANSTEDT

Mr. Chairman and members of the committee, I am Rudolph T. Danstedt, assistant to the president of the National Council of Senior Citizens and a public member of the 1974–75 Advisory Council on Social Security.

I welcome this opportunity to respond to several questions you have proposed to me, but would also like to lay forward some observations on the activities of this Advisory Council.

Your first question asks why a decision was made at such a late date and in such a short time to change the nature of the hospital insurance part of Medicare from a contributory insurance system to a system which would be supported entirely by general revenues.

I think it is important to indicate that the Council had only 9 months in which to pursue its activities—less than half the time available to the 1970–71 Advisory Council. We were not appointed and organized until April 1974, although the legislation under which we were authorized would have permitted the Secretary of the Department of Health, Education, and Welfare to appoint this Council in late 1973. This, together with the fact that we were up against the findings of the 1974 Report of the Board of Trustees that the cash benefits program of Social Security (OASDI) over a 75-year span was facing a long-range deficit of about 3 percent of payroll, caused us to focus upon the cash benefits program. Reluctantly and with considerable personal reservation, I agreed with other members of the Council that we didn't have the time to examine the Medicare program.

This decision was reflected in the activities of the Finance Committee, of which I was a member, and caused us to ask our Consultants—two economists and three actuaries—to focus exclusively on the factors that affected the cash benefit program. Early in the deliberations of the Finance Committee, as I am sure previous witnesses have indicated, we identified the problem that the automatic formula in the Social Security Act—because of double digit inflation—was producing and charged our consultants with developing a method for "decoupling" the system. Incidentally, the terms "coupling" and "decoupling" are apparently new terms in the social security vocabularly—at least I have found them to be—and various social security experts I have consulted recognized the phenomenon but had not heard the term.

I want to underline again that both the short-range and long-range deficits in the social security system are on the cash benefit side, and I think the Council acted very responsibly in analyzing the causes of this deficit, and, how through a "decoupling" system this deficit might in the course of time be considerably alleviated.

An examination of how we spent the nine 2-day meetings of the Council—between May 3 and 4, 1974 and the concluding 2-day meetings on January 19 and 20, 1975—offers an explanation but not a justification for compacting the fundamental fiscal decisions of the Council to its last two sets of 2-day meetings—actually, its very last 2-day meeting. Probably, three or four 2-day meetings were spent in general orientation and familiarization with the Social Security program. Two other 2-day meetings were devoted in substantial part, under the tight restrictions imposed by the fiscal situation, to reviewing the retirement base, the definition of disability and the minimum benefit with a yield of no great significance. As a matter of fact, several of us later rejected the proposal for the so-called liberalization of the retirement test as unnecessary, and the liberalization of the disability definition as inadequate.

In the next to the last of the 2-day meetings, the majority agreed to a proposal that would raise the wage base to $24,000 and raise the tax rate, modestly at first and then much more substantially as we moved into the twenty-first century. This formulation under the assumptions under which we operated—a fertility rate of 2.1, an average increase of 5 percent in wages and an average increase of

3 percent in consumer prices—would have provided for both the short-range and long-range deficits. A minority of us supported an increase in the wage base of $24,000, but objected to an increase in the tax rate, recommending instead that there be no increase in the tax rate, but that we call upon the general revenues, modestly at first and then in the twenty-first century more substantially, moving up perhaps well in the twenty-first century to one-third employer, one-third employee and one-third general revenues. At the last meeting of the Council, however, the majority rescinded the earlier proposal for a wage base increase to $24,000 and an increase in the tax rate, arguing that an increase to $24,000 base would interfere with capital formation and the purchase of private annuities. Thus the Council found itself on the next to last day of its deliberations without any financing proposal.

That evening, at what amounted to a "buzz" session—it was not an official meeting of the Council—and in what was a sort of fiscal shell game—the pea was found under the hospital insurance shell. The argument was advanced, as you have heard already from previous witnesses, that contributions for hospital insurance are not wage related and that benefits bore no relation to the contributions made. Therefore, it was held that there is no real reason for funding such costs by a tax on wages. Hospital expenditures, it was argued, would seem to be more properly funded from the general revenues. This proposal was then formally laid before the Council and under pressure of terminating the Council's activities and without due and deliberate consideration was approved by a majority—a vote of 8:5.

I am prepared to say that had we given this proposal the careful consideration it deserved and perhaps even postponed action until one more meeting, the proposal would not have been approved. There is no question in my mind or that of any careful student of the social security system but that the hospital insurance program is just as much social insurance as the cash benefit program. Payroll contributions to hospital insurance, as is true of the OASDI cash benefits program, constitute a contract between the worker and his government that when he retires and/or is disabled, his income falls and the incidence of illness rises, his cost of hospital care will be substantially provided for. Financing hospital insurance exclusively from the general revenues destroys the right to such hospital insurance payments, opens the door to the application of a means test and equates the program with Medicaid.

As I have stated, I am sure that had there been an opportunity for a subsequent meeting to weigh fully and carefully the implications of the action taken by the Council on its last day, this proposal would have been defeated.

You will note that there are five of us who filed supplementary statements and object strongly to the Council's action to capture hospital insurance contributions to finance the deficit in the cash benefits program. Another member of the Council, who was unable to meet the deadline for filing a supplementary statement, is also opposed to the transfer. My analysis at this point produces then a vote of 7:6 for the proposal—a bare majority.

The employee representatives on the Council, who were selected individually instead of from a panel proposed by the AFL–CIO—as has been long past practice—were in my judgment, inadequately advised by their consultant—an employee of the Department of Labor. Had they been afforded an opportunity to examine and deliberate fully the Council's proposal, I am certain they would have opposed it. My analysis now produces a vote of 4:9 against the transfer of hospital contributions. We would then have been down to the hard rock and compelled to choose between an approach similar to the one I present in my dissent or one requiring at least a 1 percent increase in the tax rate now and a much more substantial increase in the rate later.

The Council's proposal to use the general revenues for financing the hospital program got promptly vetoed by the Administration. When the Report was scheduled to be presented to HEW Secretary Weinberger on Friday, March 7, 1975, although the Secretary was not present, his presence was felt in the press statement he issued which read in part:

> The only recommendation of the Advisory Council I must oppose now is the one which calls for the introduction of substantial amounts of general revenue financing into the social security system. I think such a step would be inappropriate for a program whose strength has depended so heavily on support by working people and their employers. We should find other ways to solve the financing problems in social security.

Later on the same day a statement by the President indicated that such a shift (i.e., the use of general revenue funds for financing hospital insurance) would depart from the "earned right principle" that he strongly supports as a basic feature of social security.

The proposal which I make in my supplementary statement and dissent might possibly appeal to Mr. Weinberger and the President because it is realistic, solid and fiscally responsible. It also postpones well beyond their incumbency any use of the general revenues. The elements of this proposal are:

NCSC PROPOSALS

1. Beginning in calendar year 1977 the maximum amount counted for the computation of benefits and for contributions—the wage base—should be raised above the approximately $16,800 that can be expected to be in effect in 1977 under present law. The economic impact of such an increase would not be felt until the fall of 1977 because it is not until then that any significant number of workers would have earnings that exceed the $16,800 figure that would be in effect in any event. The exact amount of the increase in the earnings base should be determined by whether it is to be done in one step or in several steps. One alternative is to increase the amount to $24,000 in 1977 and have it rise automatically from this figure as wages increase. Another possibility is to provide for more gradual increases, that is, a lesser increase for 1977, compensated for by larger increases later. It is of interest to note that the AFL–CIO Executive Council has endorsed moving the wage base up to $28,000 over a period of years.

2. A tax on the employer's full payroll. A maximum on the benefit and contribution base for individual workers is appropriate since the amount that people pay and the amount that is credited to their record for benefit purposes should be tied together, and it would seem unreasonable under social insurance to compute benefits on the very high salaries earned by the top 2 or 3 percent of the wage-earning portion of the population. There is no similar need for a limitation on employer's payroll. The tax on employer's payroll is less now than contemplated in the original Social Security Act. There was then provided an ultimate combined employer tax rate for social security and unemployment compensation totalling 6 percent. Because of the lower proportion of wages now covered under the experience rating of unemployment compensation and the increased tax deductible advantages now available through corporate tax laws, the tax burden on employers is now significantly less than provided by the original law.

3. That since the hospital insurance program, because of the rise in the wage base, will be over financed, the 1978 scheduled increase of 0.2 percent of payroll to employees and the like amount on employers, be allocated to the cash benefit program.

4. That there be restored to the Social Security law the provision for general revenue financing that existed from 1944–50 which reads: "There is also authorized to be appropriated sums as may be required to finance the benefits and payments provided for in this title."

These first three recommendations, according to the best estimates I have been able to obtain, will solve the short-run financing problem of the cash benefit program and carry the cash benefit program on a self-sufficient basis well into 1980's. Then, depending on what happens to the wage and cost of living rates, a limited contribution may be required from the general revenues in the last decade of this century.

Finally, with respect to the twenty-first century, my statement sees no need to provide, on the basis of a highly speculative set of assumptions concerning the movement of wages and prices, a set of contribution rates in the next century that are any higher than those required to support the program over the next few decades, and have recommended that it would be more reasonable now to provide specifically for contribution income to finance the present program over such a period, and at the same time to restore to the social security law the provision for general revenue financing that was contained in the law from 1944 to 1950.

AGE DISTRIBUTION NO BARRIER

My statement further holds that the predicted change in the age composition of the population does not present any major increase in the burden of supporting non-workers. The very assumptions that lead to an increasing proportion of older people to those of working age leads to a smaller number of children per person of working age. Taking the two nonworking parts of the population together—the retired aged and children—there is little change in the ratio of dependents to workers. Thus the resources now required for the upbringing and education of children can under these population assumptions be directed toward providing for older people, at least in part, without any increased burden on current workers. Under such circumstances there is little doubt also but that labor force participation of older people would increase. Cost savings to social security would, of course, result from such increased labor force participation by older people. It is not necessary to change the legal age at which an individual becomes eligible for benefits, as discussed in the Council. With greater opportunity for employment, the cost savings will come about automatically. The proposal to change the legal age of entitlement not only violates the agreement between the social security payee and his government, but penalizes the person who chooses to retire or has to retire because of health or employment circumstances.

It is also possible that costs in the next century measured as a percentage of covered payroll will be smaller than indicated by current estimates because of greater labor force participation by women. With smaller families such a result would seem to be quite likely. Most fundamental, of course, is the long-range trend of productivity increases. Although as indicated earlier, the long-range actuarial deficit of the system is 3 percent of payroll with an assumption of 5 percent increases in wages and 3 percent increases in prices and a 6 percent of payroll deficit on a long-range assumption of a 6 percent increase in wages and a 4 percent increase in prices, an assumption of a 5 percent increase in wages and a 2 percent in prices shows the present program to be fully financed! Thus, whether or not there really is a long-range financing problem for social security depends on a highly speculative set of assumptions about fertility rates, labor force participation rates, and long-range movement of wages and prices and the productivity of the labor force.

I have enjoyed my participation on this citizens' board of review of Social Security, and the opportunity to understand the system better and to make perhaps some small contribution.

I wish that we had been allowed more time and that we had not been so burdened by the specters of double-digit inflation and recession.

I have resented on occasion what I considered over-representation of economists who seem to view the social security system as a massive tax program that needs restructuring at the expense of the benefits provided.

However, I have come out of this experience subscribing fully to the conviction contained in the title of the recently issued White Paper, endorsed by *five* former HEW Secretaries and three former Social Security Commissioners, "Social Security: A Sound and Durable Institution of Great Value," that (1) the short-term financial problems of the system are clearly manageable without radical change, and (2) that any long-range problems in financing can and will be met in a way to fully redeem the promises made to social security contributors.

Senator CHURCH. Mr. Danstedt, since you did comment on the pace with which the Council reached its conclusion, respecting the means to be followed for some, or for solving the financial problems facing social security, and since the Social Security Advisory Council did go into wage control, do you believe that representation for elderly consumers on the Council is adequate?

Mr. DANSTEDT. Well, I guess I was the only person who represented the elderly consumer on the Social Security Council. I think there was one other at the point of retirement.

Mr. SMITH. That is I.

Mr. DANSTEDT. There may have been two of us. Yes, I think, I think we ought to view the Social Security Advisory Council as not a great big technical body that is supposed to be wise and answer all of the problems of the social security system but rather as a citizens' board of review of the social security system, so I think it ought to be representative of the persons who are now availing themselves of the social security program.

I assume the reason it has an employer-employee representation is also to get representation from the groups helping to support the program. I would think it would make a great deal of sense, since this program is so important to the welfare of the older people and disabled, to insure there is representation from those areas.

Senator CHURCH. In the report, you take the position of opposing a full-time body on issues to come before the next Advisory Council. Would you care to elaborate on the reasons?

CHALLENGE TO NONGOVERNMENTAL SURVEY

Mr. DANSTEDT. As I recall, I objected very strongly in my dissent. To go outside to some nongovernmental research organizations, to make some kind of examination or study of the social security system, seems to me almost ridiculous.

Senator CHURCH. Were you afraid that might be turned over to a Brookings Institute?

Mr. DANSTEDT. No; I think there was another group. I cannot recall it at the moment. It might be even further to the right than the Brookings Institute.

Mr. SMITH. American Enterprise Institute.

Mr. DANSTEDT. We have expertise in the Social Security Administration and in other branches of Government and there are ways in which we can get volunteer help or help can be purchased.

For example, we found in the instance of the Finance Committee, the economic consultants, and actuaries very helpful to us in making our decision at that point. I do not think we need a device, say, of a special group, set up apart from the Advisory Council, to make an intensive study. We have to focus on the citizens' board-review approach.

Senator CHURCH. I notice in the President's reaction to the report of the Council, he agreed with you, Mr. Smith. He took exception to the recommendation of the Council that medicare being utilized for purpose of financing social security and that as its revenues were phased into the social security account, general revenues be used to substitute medicare.

However, the President has also recommended that the law be revised to limit the amount of benefit in the coming adjustment in July to 5 percent, instead of 8.7 percent which reflects the increase in cost of living.

What is your position with regard to that matter, Mr. Smith?

Mr. SMITH. I would not favor limiting the increase to 5 percent. I think in effect a compact has been made which the Congress is morally obligated to carry through.

Senator CHURCH. It seems to me if we are going to have a retirement program that is going to be working, it has to be made inflation proof.

Is it not true that the best thing that could be done to remedy the problems that now face social security would be to stabilize our economy?

EFFECT OF INFLATION

Mr. SMITH. Of course. I do think, however, that when the provision was installed for increasing benefits by virtue of increases in the cost of living, it may have lacked some control that would have been useful and proper.

True enough, to put it as you said, the integrity of the system needs to have some sort of increasing arrangement to overcome the ravages of cost of living but whether it needs to go to 100 percent is the question, I think.

I think the wage earners today are not being protected to that extent. People who are working currently, you and I and others, are not being fully protected; our wages are not going up as fast as inflation. We suffer in this regard, a gradual decline in the standard of living, on this account. To protect pensioners to the full extent of 100 percent may be a little out of joint as compared with the rest of the country.

Perhaps some modifications of the full increase would have been wise when the law was originally proposed and adopted, to maintain some degree of equality between those who work and those who do not want to work. That would have helped to maintain a little better control of the costs as well.

My own company has a pension plan that has a cost-of-living escalator in it but we have a definite limit on it. That, of course, is a little different proposition; it is therefor financial protection of the company, so to speak. If necessary, we supplement that further by increasing payments on a voluntary basis by action of the board of directors at the appropriate time. If and when we do, I do not think we will go all the way to the full limit of the increase in the CPI—I think that would be overbalancing the situation between the retired people and the active people.

Senator CHURCH. As I listened to Mr. Van Gorkom this morning, it struck me that all of the projects are based upon the expectation that we will continue to live with inflation for the rest of our lives or as far ahead as we can perceive. He spoke also of the suddenly changing relationship between wages and the cost of living and was unable to say for sure whether that was also a change that we would continue to live with in the future or whether it was simply a temporary phenomena but there we were able to solve the problems of stagflation in this country, which are recent problems.

It is possible, like in the Eisenhower years, to maintain a stable economy without inflation; it was possible even in the Kennedy years prior to the Vietnam war to maintain a very modest rate of inflation, about 1½ percent a year.

Now, suddenly, we are told the economy has been restructured and we will have to accept inflationary rates of very, very substantially above those in the past and we have to accept a large unemployment level as well.

Well, if that is the case, then it is not surprising that social security should suffer. Everything else based on long-term planning is in trouble and I think that we could correct the underlying problems in the economy; we would not have to worry about the future solvency of the social security system.

Mr. SMITH. You are certainly correct. I fully subscribe to that.

Senator CHURCH. Well, thank you very much, Mr. Smith. Thank you both for your testimony this morning. It has been very helpful.

The committee will meet again tomorrow morning at 10 a.m. in room 4221, Dirksen Building, for continuation of these hearings.

[Whereupon, the hearing was recessed at 12:15 p.m.]

APPENDIXES

Appendix 1

STATEMENT BY SENATOR HIRAM L. FONG ON SENATE JOINT RESOLUTION 5, REPRINTED FROM THE CONGRESSIONAL RECORD, MARCH 13, 1975

NEED FOR INDEPENDENT SOCIAL SECURITY COMMISSION REINFORCED

Mr. FONG. Mr. President, reports on social security by two panels during the past several weeks have considerably strengthened my view that there needs to be an independent, bipartisan, permanent National Social Security Commission as proposed in Senate Joint Resolution 5 which I have previously introduced with cosponsorship by Senators FANNIN, TOWER, THURMOND, BROCK, DOMENICI, and HANSEN.

The most recent of these reports was that released last Friday by the Advisory Council on Social Security. Three weeks earlier there was an important report on social security financing with special reference to long-range actuarial estimates by a special Finance Committee panel of actuaries and economists.

In both reports, there were recommendations for additional studies of the type that would be carried out on a continuing basis by the National Security Commission proposed in Senate Joint Resolution 5.

I strongly urge that every Member of the Congress give careful attention to findings by the Finance Committee panel and the Advisory Council. No less important should be careful noting of the extensive problems which these groups recognized as incapable of adequate review within the short period of time each group had for its work.

Because of the tremendous size of the social security system and the varied ways in which it has impact on every American, it is inevitable that there will always be major problems deserving of careful study by qualified experts. It is precisely for this reason that I believe creation of a permanent, bipartisan National Social Security Commission, is so important to the American people and would be extremely useful to the Congress.

One of the major recommendations by the Advisory Council affords a good example of the kind of problem that needs most thorough study and the kind that deserves much fuller exposure to public opinion and independent expert review than is possible with any short-term ad hoc review council or committee.

I have reference to the Advisory Council's recommendation that there be a gradual shift in medicare financing from the social security tax to general revenues and the application of social security tax funds so freed to the old age, survivors, and disabilities cash benefits program. This proposed abandonment of the contributory principle for financing medicare has already aroused heated critical comments even from those who strongly favor some general revenue financing of social security as a whole.

In any judgment such a radical departure from the past is one which should be studied very, very carefully—with studies and analyses made of all the alternatives and variables. Only when these alternatives are laid out for Congress, should any departure be considered from the earnings contribution financing of medicare or any other benefit program under social security.

Other recommendations by the Advisory Council deserve equally thorough analysis of a kind which I fear no group of men and women can give in so short a time as the Advisory Council had—no matter how capable or dedicated its membership may be.

SOCIAL SECURITY COMMISSION MEMBERSHIP

Because they reflect the kinds of background which should be requisites of persons named as members to the National Social Security Commission, and because their work deserves personal recognition, it is appropriate that the Finance Committee panel members, and both members and consultants for the Advisory Council on Social Security be named in these remarks.

The Finance Committee study panel consisted of:

Chairman William Hsiao, Ph. D., associate professor of economics at Harvard University and former Deputy Chief Actuary of the Social Security Administration.

Peter A. Diamond, Ph. D., associate professor of economics at Massachusetts Institute of Technology and a fellow, Econometric Society.

Meyer Melnikoff, F.S.A., senior vice president and actuary of the Prudential Insurance Co. of America and a member of the Pension Research Council at the Wharton School of the University of Pennsylvania.

Ernest J. Moorhead, F.S.A., a consulting actuary who had had employment with several insurance companies and has served as president of both the Society of Actuaries and the Academy of Actuaries.

Edmund S. Phelps, Ph. D., professor of economics at Columbia University, a fellow, Econometric Society, and a member of the board of editors of the American Economics Review.

Walter Shur, F.S.A., executive vice president of the New York Life Insurance Co. and the author of several papers published in the transactions of the Society of Actuaries, including a paper on the financing of Federal retirement systems.

Membership and consultants for the Advisory Council on Social Security were as follows:

MEMBERSHIP OF THE COUNCIL

Chairman W. Allen Wallis, chancellor of the University of Rochester, and a former Special Assistant to President Eisenhower.

Stanford D. Arnold, secretary-treasurer, Michigan State Building and Construction Trades Council, AFL–CIO.

John W. Byrnes, attorney; former U.S. Representative from Wisconsin and former ranking minority member of the House Ways and Means Committee.

Rita Ricardo Campbell, Ph. D., senior fellow, Hoover Institution, Stanford University; former member of President's Committee on Health Services Industry.

Edward J. Cleary, secretary-treasurer, New York State Building and Construction Trades Council, AFL–CIO.

Rudolph T. Danstedt, assistant to the president of the National Council of Senior Citizens.

Edwin J. Faulkner, president, Woodman Accident and Life Co.

Vernon E. Jordan, Jr., executive director, National Urban League. Mr. Jordan was unable to participate in the council's work and was represented by Thomas E. Mitchell, Washington, D.C., deputy director, Washington Bureau, National Urban League.

Elizabeth C. Norwood, assistant research director, Eastern Conference of Teamsters.

John J. Scanlon, executive vice president and chief financial officer, retired, American Telephone & Telegraph Co.

J. Henry Smith, chairman of the board, Equitable Life Assurance Society of the United States and fellow, the Society of Actuaries.

J. W. Van Gorkom, president, Trans Union Corp.

Arnold R. Weber, Ph. D., vice chairman, dean, Graduate School of Industrial Administration, Carnegie-Mellon University; former Assistant Secretary, Department of Labor; former Associated Director, Office of Management and Budget.

CONSULTANTS TO THE COUNCIL

Philip Cagan, Ph. D., professor of economics, Columbia University.

Hugh Conway, Ph. D., economist, Office of the Secretary of Labor.

Martin Feldstein, Ph. D., professor of economics, Harvard University.

Robert Kaplan, Ph. D., professor of industrial administration, Carnegie-Mellon University.

Robert J. Myers, professor of actuarial science, Temple University; former Chief Actuary, Social Security Administration and fellow, the Society of Actuaries.

Sherwin Rosen, Ph. D., professor of economics, University of Rochester.

Charles E. Trowbridge, senior vice president and chief actuary, the Bankers Life; former Chief Actuary, Social Security Administration, and fellow, the Society of Actuaries.

Howard Young, consulting actuary; special consultant to the president, United Auto Workers.

Persons such as the foregoing have precisely the kind of qualifications envisioned in Senate Joint Resolution 5 which states that members of the commission shall be individuals of recognized standing and distinction who have demonstrated capacity to discharge the great responsibilities which the resolution places upon them.

ADVISORY COUNCIL RECOMMENDS FULL-TIME REVIEW BOARD

I was especially impressed that the Advisory Council on Social Security recommended a permanent, continuing review mechanism for the social security system.

While the proposed mechanism differs from that in my Senate Joint Resolution 5, the Advisory Council's conclusion undoubtedly reflected its own experience in trying to do a thorough job under terms of the present Social Security Act. I can think of few stronger recommendations for action along the lines of Senate Joint Resolution 5.

It is especially appropriate in this connection for me to emphasize that I am not absolutely wed to the precise form and language for a National Social Security Commission which appears in Senate Joint Resolution 5.

My purpose when I first introduced this proposal in 1973 was to see that effective action is taken to reassure the American people that social security is being constantly examined in their interest by a responsible agency independent of the Social Security Administration. This still remains my primary goal.

I do believe that such a commission should be bipartisan. I feel it should report frequently to the President, the Congress, and the people, I am convinced that the method of appointing members set forth in Senate Joint Resolution 5 is highly desirable. The important matter, however is that there be a constant independent overview of social security.

The language of the Advisory Council's report calls for "a general study of social security . . . by a full-time non-Government body covering such matters as funding against pay as you go, possible effects of social security on capital formation, productivity, the proper size of the trust funds, the incidence of payroll taxes, and other basic questions."

Except for my belief that a governmental agency would probably be better, I believe the Advisory Council and I are in basic agreement on the important issue—full-time, thorough independent review of social security.

The drawback in any short-time intermittent review was given additional emphasis by the Finance Committee's Panel on Social Security Financing in its statement:

"In view of limitation of time, the Panel concentrated its study on the structure of the retirement benefits and its impact on the financing of the program. Other benefit formulas such as survivor benefits may reserve an equally thorough study."

MAGNITUDE OF SOCIAL SECURITY REQUIRES CONSTANT OVERVIEW

In my repeated calls for creation of the independent National Social Security Commission, I have reiterated that social security in many respects is the biggest business in America.

Old age, survivors, and disability cash insurance payments and health insurance benefits to approximately 30 million people during 1975 will exceed $70 billion. Over 90 percent of the American people are covered. Everyone directly or indirectly participates in its financing.

The importance of independent review of the system by experts serving an ombudsman role on behalf of all the people is made clear by these statistics.

The implications of social security, however, go far beyond the dollars in benefits and the taxes paid to provide such benefits. The system affects all efforts of individual Americans and groups to provide financial security for themselves. It has an impact on private pensions, individual insurance and savings, health care patterns, and on employment and retirement practices in our Nation.

At no time has there been an authoritative review of all these elements which affect social security or are affected by it.

I believe it is high time that we look deeply and regularly at these questions.

HOW SENATE JOINT RESOLUTION 5 WOULD CHANGE LAW

Under Senate Joint Resolution 5, the National Social Security Commission would have a continuing responsibility to study, investigate, and review the Federal old age, survivors, and disability insurance program and the health insurance programs which operate under authority of the Social Security Act.

At present, the Social Security Act provides for such an overview by the Advisory Council on Social Security, but only on an intermittent part-time basis. Under our resolution, the Advisory Council would be replaced by the full-time National Social Security Commission.

It is unfair to the American people, the Congress, and the President to rely for such important studies on an advisory council which holds a limited number of meetings during 1 year out of 4 as is now the case.

Social security is too big, too important to be the object of only part-time review. Nor is it desirable that such review should be in the hands of the Federal department charged with administration of the social security program.

If the interests of the people are to be fully safeguarded, a constant overview of social security is needed, independent of its administrators—not on a part-time, intermittent basis, but with full-time surveillance. This is the intent and purpose of the National Social Security Commission to be created by Senate Joint Resolution 5.

The importance of the Commission's work, as recognized in the resolution, is underscored by the manner of appointment of its nine members and the provision that the Commission shall be bipartisan.

The Commission chairman and four members would be appointed, on a bipartisan basis, by the President with the advice and consent of the Senate. Two members each, with no more than one from a single political party, would be appointed by the President pro tempore of the Senate and the Speaker of the House of Representatives.

This is another way in which the Commission would differ from the currently authorized Advisory Council on Social Security, whose membership is named by the Secretary of Health, Education, and Welfare.

The Commission membership unquestionably should include men or women recognized as authorities in the fields of actuarial science, economics, and other appropriate disciplines.

The National Social Security Commission, in short, should be a blue-ribbon panel capable of imaginatively and effectively responding to both specific and broad ramifications of social security. It should be independently staffed by persons able to give continuous expert attention to such ramifications.

The Commission must, of necessity, give recognition to the fact that with a program as big as social security there are changing trends which affect its operation and the needs of people whom it would serve.

Through the National Social Security Commission we would provide a new and important assurance to all the people that these trends will be given consideration. Its objective will be to give constant attendance to ways in which social security may fulfill its maximum promise for the benefit of all America.

Appendix 2

LETTERS AND STATEMENTS SUBMITTED BY INDIVIDUALS AND ORGANIZATIONS

ITEM 1. LETTER AND STATEMENT FROM ALLEN WALLIS, CHANCELLOR, UNIVERSITY OF ROCHESTER, AND CHAIRMAN, 1974 ADVISORY COUNCIL ON SOCIAL SECURITY; TO SENATOR FRANK CHURCH, DATED MARCH 11, 1975

DEAR SENATOR CHURCH: Here is my statement about the recent report of the 1974 Advisory Council on Social Security of which I was Chairman.

I regret that I cannot be present on March 18, and I appreciate your willingness to let me submit a written statement. Mr. Weber, Vice Chairman of the Council, and Mr. Van Gorkom, Chairman of the Subcommittee on Finance, will testify personally, I believe, and they can answer questions about the Council's work as well as I could.

After the end of the month I will be back in the country and will be pleased to cooperate in any way I can.

Sincerely yours,

ALLEN WALLIS.

[Enclosure]

NOVEL CHARACTERISTICS OF THE COUNCIL

The sixth Advisory Council on Social Security was different in several important respects from past Councils.

This was the first Council not to include among its members any of the men and women who created the social security system four decades ago, and not to have any member who had served on an earlier Council. This Council is unique, also, in having had only 8 months for its work instead of the normal 20 months or more.

This 1974 Council differs from previous Councils in having carried on its work entirely in public, as required by legislation enacted in 1972. One consequence of this was that before its Report had even been drafted, its principal recommendations were widely published, often with substantial inaccuracies.

This Council also dealt with social security at a time when the financial soundness of the system was receiving unusually active attention in the Congress, the news media, and the academic world.

AREAS OF COUNCIL CONSIDERATION

Because the time available to the Council was short, we focused on relatively few topics. We gave priority to the financial soundness of social security, not only because the basic law under which we were appointed required it but also because of urgent concerns recently expressed by members and staff of Congress. At our first meeting a Subcommittee on Financing was established, consisting of Rudolph T. Danstedt, Elizabeth Norwood, and J. Henry Smith, with J. W. Van Gorkom as chairman.

We gave priority also to differences in the treatment of men and women and of married and unmarried persons. This was partly because of charges that the social security program discriminates against women. It was also because the "Equal Rights" amendment to the Constitution may be nearing passage and may require changes in social security; and even if the amendment is not adopted, it appears likely that similar effects will be achieved, though less abruptly, by court decisions. At our first meeting a Subcommittee on Treatment of Men and Women was formed, consisting of Edward Cleary and John J. Scanlon, with Rita Ricardo Campbell as chairman.

We also decided at our first meeting to limit our consideration of health insurance to a cursory review of its financing. The health field alone, had we reviewed all its aspects, would have been more than we could have handled in our 8 months. Furthermore, it is receiving extensive and intensive study in connection with proposals for national health insurance, and it seemed unlikely that we could add anything.

At our second meeting we formed a Task Force on the Purposes, Objectives, and Principles of Social Security. Members were Stanford Arnold, Edwin Faulkner, and Thomas Mitchell, with John W. Byrnes as chairman.

By our third meeting we had come to realize that the operation of the new automatic cost-of-living adjustments to benefits, enacted in 1972, required correction—in particular, to make the relationship of benefits to wages in the future more predictable, more amenable to congressional control, and less subject to unpredictable variations in prices and wages. We assigned this as a problem of high priority, through the Subcommittee on Financing, to our actuarial and economic consultants.

A great deal of comment from the public and in articles or talks about social security centers on the "retirement test"—the withholding of some or all benefits from people under age 72 who earn more than a certain amount ($2,520 in 1975) but not from those who have other income, however great, or are older than 72. We decided, therefore, that we should study this issue.

THE COUNCIL'S RECOMMENDATIONS

Since the Council's report has been available for nearly 2 weeks, I will not repeat here the findings and recommendations contained in it. They are summarized at the beginning of the report. I would like to repeat, however, what I said about the Council's proposals when the reports were formally submitted.

In my personal opinion, the Advisory Council's most important recommendation is the one for revising the method of automatically adjusting benefits for inflation. This change has overriding importance because it protects the social security program against instability caused by unpredictable variations in the economy. The financial soundness of the system is increasingly in jeopardy, and stabilization of the basic benefit structure is a precondition to restoring the soundness and predictability of social security financing.

Our recommendation for stabilizing the relation between benefits and preretirement income should not be controversial, but unfortunately it is rather technical and hard to understand. The Council itself did not appreciate fully the importance of this issue until we had been studying social security for over two months. Eventually, though, we were unanimous in our recommendation, and so were our economic and actuarial consultants.

Our second most important recommendation, in my personal opinion, is that benefits not related to earnings should not be financed from the earnings-related payroll tax. The most important application of the principle would be to remove Medicare from payroll-tax financing, and transfer up to 1.8 percent of the present total tax of 11.7 percent to the basic old age, survivors, and disability insurance which is generally thought of as "social security." Several members of the Council consider this the single most important recommendation because they favor financing social security from general revenues rather than from the payroll tax exclusively, and they regard this as acceptance of that idea. A majority of the Council, however, opposed general revenue financing and felt that removing Medicare and other benefits not related to earnings from support by the earnings-related payroll tax will protect the principal that core social security benefits should be related to earnings and financed by a tax related to earnings.

The Council's third most important recommendation was our urging that before the next Advisory Council, which under the law would report four years from now, there be a comprehensive study of basic issues such as full reserve funding vs. current cost financing; the effects of social security on productivity, capital formation, and private savings; the relation between private pensions and social security; and the appropriate size of the trust fund. Such fundamental questions need to be addressed in greater depth. As pointed out by Dr. Rita Ricardo Campbell in her supplementary comment, there is a tendency for those considering changes in social security to find themselves tinkering at the edges of a program that in 40 years has grown so huge and complex that even the well-informed citizen cannot understand it, and that has been affected by tremendous social and economic changes, extensive new welfare system, and inter-related tax laws.

Finally, although the Council has recommended very little about the treatment of women under social security, I hope that the Council's chapter on this subject, the report of its subcommittee, and the supplementary statement by Dr. Campbell will direct serious attention to this important issue. The Council did recommend extending to men certain benefits now available only to women. My impression is that the Council's major concern was that women not lose these important benefits if the "Equal Rights" amendment to the Constitution is adopted. We believed that its adoption was imminent and would require either withdrawing the benefits from women or extending them to men. Developments in the week after our report was submitted suggest that adoption of the amendment may not be as imminent as we believed three months ago when we concluded our consideration of sex and marital differences in social security programs.

ITEM 2. LETTER FROM J. W. VAN GORKOM,* PRESIDENT, TRANS UNION CORP.; TO SENATOR FRANK CHURCH, DATED APRIL 3, 1975

MY DEAR SENATOR CHURCH: This is in response to your letter of March 24, in which you posed three questions. The first one refers to the testimony of Dr. Schulz** and raises very directly the whole philosophy of a Social Security system.

It is true that the Council did not address itself to the adequacy of Social Security benefits. It did recommend "decoupling" the system in order to stabilize replacement ratios, but it did not attempt to establish what the replacement ratio should be for each level of income. First, it did not have nearly enough time to adequately investigate such a broad question—a question so broad that Congress itself has never really come to grips with it. Secondly, it was aware that it might be impossible to obtain agreement even among very reasonable people as to what constitutes a reasonable replacement ratio.

Even more fundamental, however, is the basic nature of the three-tier system. I cannot stress too strongly that it was recognized from the beginning that Social Security, *by itself*, was never expected to do the total job of providing adequate retirement income for *all* people. To do so, Social Security would have to levy a much higher tax or change its basic character by using general revenues. The system has produced an adequate amount for a large number of people. Some of those without an adequate minimum from Social Security have had private means (the second tier) which keep them above the subsistence level. There still remains another group, however, that does not receive an adequate amount from Social Security and which does not have private means. This group was to be aided by welfare or needs programs which formed the third tier. The supplemental security income program is a perfect example of such a program. It helps those who do not have a basic minimum and it is financed from general revenues because there is no effort made to relate the benefits to wages earned or taxes paid by the individual beneficiary. If programs like SSI are not adequate to the task then they can be increased to that level which Congress deems adequate. This is the way the system is designed to work. It has worked well because it has permitted Social Security to remain a non-welfare plan where benefits are geared to wages earned and taxes paid.

If, as Dr. Schulz would indicate, it is desired to have Social Security do the entire job without any needs test, then the dilemma occurs: either raise the tax very substantially or modify the system to a point where it loses its basic characteristics. To do the whole job in Social Security, replacement ratios would have to be increased substantially for certain income levels. This could be done by raising the entire benefit structure, which would be very costly because it would also raise the benefit levels of individuals who are already receiving an adequate benefit. Or it could be accomplished by further weighting of the lower end of the benefit scale. This latter step would further distort the relationship between wages and benefits and tend to weaken the sense of responsibility of the worker which grows out of his recognition that there has been some reasonable relationship between his wages (and taxes) and his benefits.

The plain fact is that some people in the labor force work sporadically or at very low wages, and sometimes a bit of both. This creates an average wage which cannot yield even a subsistence benefit unless the replacement ratio is inordinately high. The Social Security system can be made to yield such a benefit, but

*See statement, p. 820.
**For Mr. Schulz comments, see p. 873.

it would produce the distortion described above or it would raise all benefits and thereby incur a much higher tax.

Automatic Increases Create Problem

There is also the question of financing. The Council was aware that the system already faces serious financial problems. Congress did solve one of the basic problems of the elderly in 1972, when it provided for automatic benefit increases to maintain their purchasing power even in the face of rising prices. That step, coupled with a change in the relationship of wage and price increases, has created a financial problem for the system. Dr. Schulz indicates that benefits should be further increased to help those who are not receiving a basic minimum. This must mean either substantially higher taxes or an infusion of general revenues. The former would impact very hard on those persons in the lower wage brackets and the latter would begin the destruction of the Social Security system as we have known it by changing its basic character.

We are all sensitive to the needs of those over 65 who have less than adequate means. They must be provided for in some way. Our basic thesis is simply this: It is *not* necessary to change the basic character of Social Security in order to help those people. We can maintain the integrity and philosophy of Social Security and still help those people, at the lowest possible cost, with a program based on demonstrated need.

If my concept is followed, then the replacement ratios should be set at a level that can be sustained by a tax level that is deemed acceptable by the Congress, recognizing that such replacement levels will still be weighted in favor of the low paid person. Today, for example, the replacement ratio for a person who has been receiving the maximum wage is about 32 percent, while the replacement ratio for the person receiving the minimum wage is about 62 percent. That is already a rather sizable disparity and further changes in favor of the low paid in order to solve the problem referred to by Dr. Schulz will eventually change the worker's attitude with regard to the relationship of the taxes he pays and the benefits he receives. Obviously, no one can say where that point lies, but I believe it to be a real problem.

It was reasoning of this type that also influenced the Council in not attempting to come to grips with the issue of a proper replacement ratio. This is the kind of problem which needs to be addressed in a definitive way by some competent group that can spend more time on it than we were allotted. Eventually, of course, it is the problem of Congress.

Q. 2 and 3—With regard to your second question on the financing of Medicare, I have the following comments. I would first question why Medicare is under Social Security at all. The only thing it has in common with OASDI is that both plans involve the elderly. The OASDI system is a wage replacement plan and the benefits, therefore, are geared to the wages which they are supposed to replace. Medicare is a health insurance plan which happens to cover only the elderly at the present time. The benefits are not geared in any way to wages.

I would begin then by saying that even if it was desired to finance Medicare by a tax on wages, it should not have been considered a part of OASDI and it should not have been lumped with it because it tends to obscure the basic function of the wage replacement system. I cannot say it is wholly wrong to use a wage tax to finance a health plan for the elderly, but it would be just as proper to finance it with general revenues or an increase in the income tax. On the other hand, the OASDI system should definitely be financed by a tax on wages because the benefits flow directly therefrom and the benefits are intended to be paid as a matter of right. To be paid as a matter of right, they must be "paid for" by the recipient, and this is accomplishment by the wage tax.

When the federal health insurance program for all age groups has been adopted, I, personally, believe that it should encompass the Medicare program as well. How that plan should be financed will be up to Congress. It is clear, however, that the people who will have the greatest need for that plan will probably be those least able to pay for it. I doubt, therefore, whether anything but general revenues will be adequate to fund such a plan. I agree with you that using general revenues will probably lead to a needs test, but I see no harm in that, and it will permit us to provide the greatest need. If we attempt to provide the benefits of the system to everyone, without regard to need, the tax is going to be very high and the low paid people will be unable to handle it. This will then mean some kind of weighting, such as we have in Social Security, but the weighting will have to be even greater than it is in the case of Social Security because we will not want to limit the benefits.

As I stated at the hearings, reasonable men can obviously differ on these points, particularly questions 2 and 3. There is no categorical answer to these points and I am happy to know that men like you are devoting time to trying to solve them in some equitable way. If I can be of any further help, do not hesitate to call. I am by no means an expert, but I am an interested citizen.

Sincerely yours,

J. W. VAN GORKOM.

ITEM 3. LETTER FROM J. HENRY SMITH,* CHAIRMAN OF THE BOARD, THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES; TO SENATOR FRANK CHURCH, DATED APRIL 3, 1975

MY DEAR SENATOR CHURCH: I appreciated the opportunity of appearing before your Special Committee on Aging, and I am happy to be of further assistance by answering the additional questions noted in your letter of March 24.

In my prepared testimony, I have remarked in detail on the subject of the proper relationship between private and social insurance protection; and I would be pleased to summarize those remarks at this time.

First, I would note that I am in full agreement with the endorsement given by the Advisory Council on Social Security to the preservation of a three-tiered income maintenance system. In that system, OASDI serves the primary role of providing basic economic security in the event of retirement, disability or death of workers. That central core of protection is undergirded by means-tested welfare programs for the needy; and it is supplemented by private efforts, group and individual, to fulfill protection needs and desires above and beyond the floor of protection provided through the social security program.

The social security program was introduced originally to prevent workers and their dependents from slipping into poverty and hardship. That should continue to be its rationale and its dimensions should be drawn accordingly. The private supplemental arrangements allow one to build on the basic protection provided by government to obtain income levels more appropriate to one's earnings levels during active employment.

Thus the government and the institutions of private thrift are joined together in a partnership with obligations by each to the other. The government can expect us in the private sector to broaden our coverage and increase the adequacy of our offerings, to improve cost and quality controls, to be responsive to needs, and to be innovative and constructive to change as change is warranted. We, on our part, hope that the government will encourage private thrift, that it will avoid disabling legislation, and that it will restrict the operations of the social security sector so that it does not unduly invade the private sector's sphere of operations. Such an ongoing arrangement has sound purposes and high potential and we in the private sector will vigorously prosecute our job to keep the partnership an effective, constructive and healthy one.

I think your second question is more one of semantics than anything else. Yes, I consider social security to be social insurance. Though social insurance is different in its characteristics from private insurance—and it should be—it does provide financial protection against defined hazards through a pooling of contributions and a sharing of risks.

The funding systems of the two are, as you know, quite different, one rests on an average tax rate on today's workers to meet current costs and the other is a level payment contract which includes higher than called for early payments which together with interest accumulation results in lower than called for later payments. The social security system is an intergenerational, income-transfer mechanism whereas the private arrangement is based on individual equity. To be soundly financed, private insurance and pension plans require (unlike social security) the accumulation of large dedicated funds. These funds must be invested and so become a source of much of the capital needed in this country for the nourishment and expansion of our industry and commerce—a need that will grow in the capital hungry days of the future. Thus, this is another important reason for delimiting the government's share in the ongoing partnership described above.

*See statement, p. 846.

In response to your third question, I would have to reply with a cautious "yes." I recognize that there may be additional, specific limited purposes for which general revenue financing may be appropriate (though I may be hard put at this time to name a few) but generally I would be opposed to the use of such revenues on any broad scale for financing the overall social security program. Such indirect financing masks the true cost of adding benefit liberalizations and could easily lead to pressures for unwarranted increases in benefits. Tying the program to payroll contributions serves to prevent unreasonable demands for increases in benefits. The latter tie is needed to foster a sense of responsibility in that a worker should know that higher benefits require higher contributions.

More important, however, is the fact that recourse to general revenues would change the insurance nature of the program and might lead to strong pressures for the introduction of a needs test for many social security benefits. The fact that the program is supported almost exclusively from the contributions of covered workers and their employers accords with the insurance aspects of the program and accounts for the widespread public acceptance and confidence in the program.

It has been my pleasure to have been able to cooperate with you and your Committee in your pursuit of these most important matters, and I wish you every success in your endeavors along this line.

Sincerely,

J. HENRY SMITH.

Appendix 3

ITEM 1. IMPACT OF INFLATION AND POPULATION TRENDS UPON SOCIAL SECURITY SYSTEM: SUMMARY OF RECENT APPRAISAL*

A. "White Paper"[1] Estimate

The authors[2] of the "White Paper" concluded that the Social Security system is still sound and healthy, despite the need for additional future financing. Automatic cost-of-living benefit increases are outrunning the additional income from higher wages because the current rate of inflation is so extraordinarily high. Over the next 25 years the authors estimated that it would be necessary to increase income for the cash benefits program by about 10 to 15 percent. The additional income, the signatories noted, could come in part from an increase in the wage base, an increase in the contribution rate, or from general revenues. The "White Paper" further stressed, "In any event, the size of the problem over the next 25 years is easily manageable and certainly does not constitute a financial crisis.

The fertility rate is now slightly below zero population growth. A continuation of this low rate would mean that the population aged 20 to 65 would stabilize early in the 21st century, but the number of older people would continue to grow for some time. However, active workers may not be required to support any more non-workers than they do now, even with the changed fertility rates. They may simply support more older people and fewer younger persons.

There are many ways that the next generation may choose to deal with problems caused by a larger proportion of older persons to the working population, including:

1. Increased labor force participation for older people, and thus reduce the burden of retirement benefits.
2. With smaller families more women might work, reducing the ratio of retired persons to active workers.

Moreover, production increases over the long run may help meet the problem of supporting a larger number of older persons.

B. Social Security Board of Trustees Estimate

In June 1974 the Board of Trustees (Secretary of the Treasury, Secretary of Labor, and Secretary of Health, Education, and Welfare) concluded that the OASDI trust funds showed a long-range (over a 75-year period) actuarial deficit of 2.98 percent of taxable payroll. Three major factors were cited by the Trustees:

1. A change in the demographic projections (primarily fertility assumptions) which accounted for about 76 percent of the increase in the actuarial deficit (compared with the prior estimate);
2. A higher estimated inflationary rate; and
3. An increase in the number of disabled-worker benefits being awarded.

The Trustees said:

> "Although the new population and fertility projections will have a major impact after the turn of the century on the long-range cost estimates, they will not have a significant effect in the short run."

C. Finance Committee Panel Actuarial Estimate

In February 1975 a Panel on Social Security Financing submitted its report, based upon new data, to the Senate Finance Committee concerning the actuarial condition of the cash benefits program. The six-member panel projected a 6

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*Prepared by the staff of the Senate Committee on Aging.

[1] "Social Security: A Sound and Durable Institution of Great Value."

[2] Wilbur Cohen, Robert H. Finch, Arthur S. Flemming, John W. Gardner, Elliot L. Richardson, Robert M. Ball, William L. Mitchell, and Charles L. Schottland.

percent long-range deficit. Two principal reasons were cited for the higher estimated deficit:

1. The Finance Committee Panel assumes that fertility rates will continue their downward trend until 1980 before beginning an upswing. The 1974 Trustees' report assumed that the trough in fertility rates had been reached.

2. The Finance Committee Panel assumed a long-range average inflationary rate of 4 percent, compared with 3 percent in the Trustees' report.

U.S. POPULATION

[In millions of people]

	1975	1980	1990	2000	2025	2050
Ages 20 to 64:						
1974 Trustees' report	122	132	147	159	173	181
Finance Committee panel	122	132	147	156	154	154
Ages 65 and over:						
Trustees' report	23	25	29	31	48	51
Finance Committee panel	23	25	29	31	49	50

FERTILITY RATES,[1] ACTUAL AND ASSUMED

	Actual				Assumed					
	1965	1970	1972	1973	1975	1980	1990	2000	2025	2050
Trustees' report	2.9	2.4	2.0	1.9	1.9	2.0	2.1	2.1	2.1	2.1
Finance Committee panel	2.9	2.4	2.0	1.9	1.9	1.6	1.8	1.9	2.1	2.1

[1] Fertility rate—the number of children that a woman entering childbearing ages can expect to have throughout her childbearing years.

The Finance Committee Panel pointed out that about one-third (1 percent of taxable payroll) of the difference between their projected long-term deficit and the Board of Trustees' 1974 estimate was because of demographic factors. The remainder is attributed to anticipated higher inflationary levels.

D. Advisory Council on Social Security[8]

The Social Security Advisory Council concluded that changes in population assumptions had the greatest impact concerning the larger projected long-range actuarial deficits. These changes are reflected in the following ways:

1. Today there are about 30 beneficiaries for every 100 workers.
2. Projections for 2030 are based upon 45 beneficiaries for every 100 workers.

The Council also noted that 76 percent of the increase in the actuarial deficit since the last review was attributed to changed population assumptions.

High inflationary rates have also materially increased the estimated deficit. In early 1974 the Board of Trustees projected a 4.4 percent cost-of-living raise for Social Security beneficiaries in July 1975. The Social Security Advisory Council estimates that the increase will be approximately 8.5 percent. This, in turn, will boost the long-range deficit by 0.51 percent of taxable payroll.

ITEM 2. RESPONSE BY PRESIDENT FORD TO SOCIAL SECURITY ADVISORY COUNCIL RECOMMENDATIONS

I have received today the final report of the Advisory Council on Social Security. I concur strongly in the Council's unanimous endorsement of the basic principles of the social security system.

In my view, the most important recommendation of the Council calls for the stabilization of the benefit structure so that future benefits will maintain a consistent relationship to earnings and will not be so vulnerable to changes in the economy.

[8] In their report issued on March 7, 1975.

Consequently, I have directed the Secretary of Health, Education, and Welfare to present to me a series of proposals for stabilizing the benefit structure. This will enable me to make recommendations to the Congress as early as possible.

Stabilization of the benefit structure, however, will not provide all the additional revenues that will eventually be required by social security. While existing reserves are adequate to maintain the fund's financial integrity for the next several years, I want to ensure the integrity of the system into the 21st century. Therefore, I have asked the Vice President to have the Domestic Council explore alternative approaches to financing and to make appropriate recommendations to me.

I strongly support the "earned right" principle that has been a basic feature of social security since its inception 40 years ago. Therefore, I am opposed to the Advisory Council's specific recommendation calling for this transfer of Medicare financing from the Social Security trust funds to general funds of the Treasury.

ITEM 3. MAJOR FINDINGS AND RECOMMENDATIONS: THE ADVISORY COUNCIL ON SOCIAL SECURITY: 1975

Section 706 of the Social Security Act requires appointment every four years of an Advisory Council on Social Security consisting of a chairman and 12 other members representing the general public, the self-employed, and organizations of employers and employees. The latest Advisory Council held nine 2-day meetings in 1974–5. It was the first Social Security Advisory Council to conduct public meetings as required by the Federal Advisory Committee Act, and thus many of its deliberations were discussed in the news media before its final recommendations were made.

What follows is a summary of Major Findings and Recommendations* as officially released by the Council on March 7, 1975.

SUMMARY OF MAJOR FINDINGS AND RECOMMENDATIONS [1]

A. CASH BENEFITS

1. *Purpose and principles.* The earnings-related OASDI program should remain the Nation's primary means of providing economic security in the event of retirement, death, or disability. It should be supplemented by effective private pensions, individual insurance, savings, and other investments; and it should be undergirded by effective means-tested programs. Future changes in OASDI should conform to the fundamental principles of the program: universal compulsory coverage, earnings-related benefits paid without a test of need, and contributions toward the cost of the program from covered workers and employers.

2. *Benefit structure—replacement rates.* The provisions of present law for computing average monthly earnings, on which benefits are based, and for adjusting the benefit table in the law to changes in prices may result over the long range in unintended, unpredictable, and undesirable variations in the level of benefits. The benefit structure should be revised to maintain the levels of benefits in relation to preretirement earnings levels that now prevail. Benefits for workers coming on the rolls in the future should be computed on the basis of a revised benefit formula using past earnings indexed to take account of changes during their working lives in the average earnings of all covered workers. As under present law, benefits for people on the rolls should continue to be increased as price levels increase.

3. *Retirement test.* The provisions of the present retirement test should be modified so that beneficiaries who work can retain more of their benefits. Instead of reducing benefits by one dollar for every two dollars of earnings above the exempt amount of earnings, as under present law, one dollar of benefits should be withheld for every three dollars of earnings between the exempt amount and twice

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*The Council's findings and recommendations reflect a consensus of the Council and not necessarily the precise view of any individual member on any issue.

[1] The Council's findings and recommendations reflect a consensus of the Council and not necessarily the precise view of any individual member on any issue. To the extent that Council members have chosen to express their differences from the Council's findings and recommendations, such expressions are contained in the section of statements at the end of the report. Footnotes at appropriate points in the body of the report call attention to these supplementary statements.

the exempt amount, and one dollar for two dollars above that level. Also, the provision under which a full benefit may be paid for any month in which a beneficiary earns less than one-twelfth of the annual exempt amount should be eliminated, except for the first year of entitlement to benefits. The test should be based on annual earnings.

4. *Treatment of men and women.* The requirements for entitlement to dependents' and survivors' benefits that apply to women should apply equally to men; that is, benefits should be provided for fathers and divorced men as they are for mothers and divorced women and benefits for husbands and widowers should be provided without a support test as are benefits for wives and widows. At the same time, the law should be changed, effective prospectively, so that pensions based on a person's work in employment not covered by social security will be subtracted from his social security dependents' benefits. Other provisions of the social security program which are the same for men and women but which are criticized because they appear to have different average effects on men and women (or different average effects on the married and the unmarried) should not be changed.

5. *Other recommendations.*

a. *Universal compulsory coverage.* Although social security covers over 90 percent of workers, the gaps that remain often result in unwarranted duplication of benefits. Social security coverage should be applicable to all gainful employment. Ways should be developed to extend coverage immediately to those kinds of employment, especially public employment, for which coordinated coverage under social security and existing staff-retirement systems would assure that total benefits are reasonably related to a worker's lifetime earnings and contributions.

b. *Minimum benefit.* Partly because of the gaps in social security coverage, the minimum benefit is frequently a "windfall" to those, such as Federal retirees, who are already receiving a pension based on earnings in employment not covered by social security. Almost all workers who have worked in social security employment with some regularity become entitled to higher than minimum social security benefits. The minimum benefit in present law should be frozen at its level at the time the new benefit structure recommended under number 2 above goes into effect and the new system should not pay benefits exceeding 100 percent of the indexed earnings on which the benefit is based.

c. *Definition of disability.* The definition of disability should be revised to provide disability benefits for workers aged 55 or over who cannot qualify for benefits under present law but who are so disabled that they can no longer perform jobs for which they have considerable regular experience. These benefits should be 80 percent of the benefits for those disabled workers who qualify under the present law.

d. *Miscellaneous.* Further study is needed on three matters; the effects of the social security program on different racial and ethnic groups, ways of simplifying the social security program and its administration, and the frequency of cost-of-living adjustments in benefits. In addition, a general study of social security should be made by a full-time non-Government body, covering such matters as funding vs. pay-as-you-go, possible effects of social security on capital formation, productivity, the proper size of the trust funds, the incidence of payroll taxes, and other basic questions.

B. FINANCING

1. *Actuarial status.* The cash benefits program needs a comparatively small amount of additional financing immediately in order to maintain the trust funds levels. Beginning about 30 years from now, in 2005, the program faces serious deficits. Steps should be taken soon to assure the financial integrity and long-range financial soundness of the program.

2. *Tax rates.*

a. *Employee-employer:* No increase should be made, beyond those already scheduled in present law, in the total tax rates for employees and employers for cash benefits and hospital insurance. However, the OASDI tax rate should be gradually increased, as OASDI costs increase, and the increases should be met by reallocating taxes now scheduled in the law for part A (hospital insurance) of the Medicare program. Income lost to the hospital insurance program by this reallocation should be made up from the general funds of the Treasury. Hospital insurance benefits are not related to earnings, so should be phased out of support from the payroll tax.

b. *Self-employed:* The present 7-percent limitation on the tax rate for the self-employed should be removed. The self-employment OASDI tax rate should be the same multiple of the employee contribution rate as was fixed at the time the self-employed were first covered—150 percent.

3. *Retirement age.* The Council recognizes that under current demographic projections there will be a sharp rise in the number of people who will have reached retirement age relative to the working age population in the first several decades of the next century. Although the Council is not recommending an increase in the age of eligibility for social security retirement benefits, the Council does believe that such a change might merit consideration in the next century, when the financial burden of social security taxes on people still working may become excessive.

ITEM 4. SUMMARY OF MAJOR RECOMMENDATIONS FOR THE UNITED STATES AS EXPRESSED IN PROVIDING ADEQUATE RETIREMENT INCOME: PENSION REFORM IN THE UNITED STATES AND ABROAD*

This book focuses on the Social Security old-age pension programs in the United States and a number of other countries and "attempts to place pension developments at home and abroad within an analytical framework that we (the authors) hope will clarify some of the important decisions that must be made in the near future."

One of the major recommendations for reform in the United States:

"Specifically, we propose the adoption of a standard that will provide inflation-protection benefits equal to a specified percentage of pre-retirement average earnings with minimum and maximum benefit levels." The minimum guaranteed replacement through Social Security is put at about 55 percent by the authors.

Implementation of a standard of at least 55 percent of the individual's or family's (if married) preretirement average earnings during the best ten of the last 15 years prior to retirement would admittedly require a large increase in Social Security revenues. "It will probably be necessary, therefore," say the authors, that:

"1. there be a phase-in schedule for increased benefits and revenues over a period of five to ten years;

"2. in order to keep the contribution rates paid by individuals as low as possible and minimize the inequities of regressive taxation, general revenue financing should be used to meet current benefit payment obligations to individuals who have contributed amounts below their expected actuarial benefits. Current beneficiaries, on average, will receive much greater benefit amounts than the contribution they paid into the system. Current workers should not be required to meet these obligations through a proportional/regressive tax system."

The authors also call for improved private pension supplements, encouragement of personal saving, better health cost protection, and improved part-time employment opportunities for older persons.

ITEM 5. LETTER FROM JAMES H. SCHULZ, ASSOCIATE PROFESSOR, WELFARE ECONOMICS, BRANDEIS UNIVERSITY; TO J. W. VAN GORKOM, DATED JUNE 3, 1975

DEAR MR. VAN GORKOM: Senator Frank Church has sent me a copy of your April 3 letter to him which, in part, discusses my testimony before the committee. Apparently Senator Church did not send you a copy of my testimony, since you attribute to me a position which I did not take.

*Written by Dr. James Schulz and others, published in 1974. Dr. Schulz was to testify before the Commitee on Aging at the March 19 hearing.

First, nowhere in my statement did I advocate that social security should "do the entire job [of eliminating poverty among the aged] without any needs test." Quite the contrary, I pointed out in my statement the decline in poverty and the need to focus our policy discussions on the nonpoor aged.

Second, with regard to raising replacement rates provided by social security, I am surprised that you would assume that I advocate raising these rates regardless of the labor force history of the individual. I agree (in the interest of equity) that those who work sporadically should receive lower pensions, but I would want to work out a more equitable treatment of the special situation facing most married women with multiple roles.

You state in your letter that I favor increasing benefits to help those "not receiving a basic minimum." Since I did not talk about providing minimum income through social security, I do not understand the reference. And I did not recommend raising benefits for low-income workers, thereby giving them higher pension replacement rates.

What I did say is that we should raise the general benefit levels of social security to provide greater adequacy, using an earnings replacement concept as the measure of adequacy. Your objection to doing this on the grounds that it would require higher taxes just dodges the issue; have you stopped buying automobiles or riding taxis simply because their cost has increased? Costs are always going up, and anything better usually costs more! As I indicated in the hearings, it's a matter of priorities. (And a question of who pays and who gets how much.)

The most important point I tried to make in my testimony is that freezing replacement rates at current levels dooms generations of retirees *without* private pension coverage or *without* adequate private pension benefits to a drastic drop in living standards when they retire. Our dual pension system is developing a pension elite and is creating two classes of retirees.

I argue that we need to face up to this problem. There are different ways of responding, and my recommendation to improve the universal pension (i.e., social security) for all and thereby create a minor role for private pensions is but one approach. But at very least, the issue should be raised and discussed.

Of course, I am aware of the time limitations of the Council. But if you did not have time to discuss and evaluate the adequacy issue, you should not have so blithely recommended that replacement rates should stay at current levels. Yet again, as in the Council's report, your letter to Senator Church discusses why benefits should not be raised but then goes on to state that the Council did *not* attempt to come "to grips with the issue of a proper replacement ratio."

JAMES H. SCHULZ.

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