STATEMENT OF THE
U.S. GENERAL ACCOUNTING OFFICE
ON THE NATIONAL COMMISSION
ON SOCIAL SECURITY REFORM RECOMMENDATIONS

COMMITEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
Chairman:

The General Accounting Office, as an independent agency reporting to the Congress, has made numerous studies of the social security system. Drawing on this experience, we wish to share our observations regarding the recommendations of the National Commission on Social Security Reform.

In January 1983 the Commission reported its recommendations for resolving the short- and long-range problems of the social security trust funds. These recommendations were based on a year long study by the Commission and represented a bipartisan approach for dealing with the trust funds' financial problems.

Before deciding on options to recommend, the Commission first defined the extent of the problem. It determined that the short-term deficit of the trust funds was between $150 and $200 billion through 1989 and that the long-term deficit over the next 75 years averaged about 1.8 percent of taxable payroll. With this as its target, the Commission chose options which it believes will resolve the entire short-term deficit and about two-thirds of the long-term deficit.

The Commission has stated that its final recommendations are a result of compromise. The recommendations attempt to balance three methods for eliminating the projected trust fund deficits--increasing taxes, curtailing benefits, and providing general revenue assistance to the trust funds.
The extent to which the short- and long-term needs are met will depend in part on future economic and demographic factors, and upon additional actions taken by the Congress to address the remaining deficit which the Commission's proposals will not rectify.

We are providing the following information for the consideration of the Congress in its deliberation of the Commission's recommendations.

PAST REFORM EXPERIENCE COULD REPEAT

In Secretary Schweiker's testimony before this Committee on February 3, 1983, he recalled that the trust funds were in a similarly difficult financial position in 1977 and that the amendments passed by the Congress in 1977 were to have addressed the short- and long-term gap between expenditures and revenues. The changes adopted by the Congress included increasing the social security tax and reducing certain benefits. Using what were considered reasonable rather than the pessimistic economic assumptions available in 1977, it was projected that adequate funds would be available within the social security trust funds to meet benefit payments until beyond the year 2025. Quoting Secretary Schweiker's February 3 testimony:

"But economic assumptions that seemed reasonable at the time proved wrong. Beginning with 1979, economic performance has been substantially worse than even the pessimistic assumptions made in 1977. Thus, by 1980 Social Security was once again facing a financing crisis."
In 1982, the National Commission used pessimistic actuarial assumptions to identify the size of the short-range financial deficit in the social security trust funds. However, even those assumptions have now been brought under some question by revised estimates made available by Social Security's Office of the Actuary which show the estimated shortfall will be $198 billion, with the Commission's recommendations meeting only $180 billion of that amount. Therefore, should economic conditions prove to be less favorable than those anticipated by the Commission, the Congress would be faced with the need for additional short-term social security changes to bring about financial stability. It is also true, of course, that the economy might perform better than indicated by the most current projections. In that event, the magnitude of the financial problem faced by the trust funds may diminish. In our judgment, however, it would be imprudent to base policy on the more optimistic projections.

LONG-TERM FINANCIAL REQUIREMENTS PARTIALLY SATISFIED

While the Commission was able to reach a consensus for meeting the short-range financial requirements of the trust funds, the set of recommendations it offered will meet only about two-thirds of the projected long-term financial requirements. Numerous proposed solutions to bring greater financial stability to the trust funds and to meet the remaining one-third long-term requirement were studied and debated; however, a consensus among the Commissioners could not be reached on which of the options would receive bipartisan support. Seven of the 12
members agreed that the remaining one-third of the long-term financial shortfall should be met by a deferred, gradual increase of the normal retirement age. The other 5 members agreed to an increase in the payroll contribution in 2010 on the employer and the employee, with the employee's share of the increase offset by a refundable income tax credit.

Unable to reach a consensus, the Commission recognized that the long-term financial needs of the trust funds would not be met by its recommendations and that .58 percent of taxable payroll is a shortfall that the Congress will be required to address in the future. However, the size of the shortfall may well be larger than .58 percent because, subsequent to the Commission rendering its report, the Secretary of HHS disclosed that the 1983 Social Security Trustees' Report will contain revised assumptions that reflect lower birth rates and a lack of real wage growth. As a result of the revised assumptions, the long-range deficit projected for the trust funds will be greater than the 1.8 percent of taxable payroll estimated by the Social Security Reform Commission.

AVAILABILITY OF FUTURE FUNDING SOURCES

As mentioned earlier, the Commission used the three funding sources available to it--increased taxes, decreased benefits, and the infusion of general revenues. Should the Congress decide to address the long-term financial needs of the trust funds in the future, presumably these three financing sources would be available. However, any option which involves changes
in benefits generally must allow for an adequate period before implementation, so that those who would be affected will have ample time to prepare and adjust their retirement planning.

Also, to the extent that fewer workers will be supporting social security in the future (two workers for each beneficiary by 2030 under intermediate assumptions and 1.6 workers for each beneficiary under pessimistic assumptions), increasing employee taxes as a major revenue source in the longer term may become prohibitive. Finally, with regard to using general revenues, as additional general revenues are infused into social security, additional tax revenues could be required to meet other budgetary needs.

OPTIONS FOR IMPLEMENTING THE COMMISSION'S RECOMMENDATIONS

In view of the magnitude of the financial problems facing the trust funds and the recognition that part of the projected deficits will not be rectified by the Commission's recommendations, GAO offers the following suggestions which we believe could either (1) bring greater savings to the trust funds; (2) treat people more consistently; or (3) avoid administrative difficulties that could be associated with some of the recommendations as currently offered.
Cost of Living Adjustments

The Commission has recommended that, beginning in 1988, if the trust funds' balance as of the beginning of the year is less than 20 percent of the amount needed to pay benefits that year, the automatic cost-of-living adjustment (COLA) should be made on the lower of the Consumer Price Index (CPI) increase or the increase in wages.

With regard to automatic COLAs, it is worthwhile to recall that prior to 1972 COLAs were given through the Executive and Legislative decisionmaking process, taking into consideration economic and other relevant factors. It is also worthwhile to recall that in 1970 the trust funds had more than 12 months of benefits on hand and projections showed continually favorable financial conditions for social security. However, by 1973, the Board of Trustees of the trust funds began to project both short- and long-term financing problems. Today, there is widespread agreement that the major factors that have contributed to the trust funds' financial problems have been the high inflation rate experienced during recent years and the inflexibility of the automatic COLA process to allow Executive and Legislative decision makers to modify such raises. Also, the automatic COLA recommended by the Commission does not provide the flexibility for reducing, suspending, or excluding a cost-of-living payment when funds are not available to make the regularly scheduled monthly payments.
In view of the issues involved with automatic COLAs, the Congress may wish to give consideration to putting itself in the same position it was in before 1972, when the automatic COLA was placed into law.

Another aspect of the Commission's recommendation that the Congress may wish to consider involves the administrative difficulty the recommendation will cause Social Security as currently worded. The recommendation provides that, if the trust fund ratio is 32 percent or more at the beginning of a year, payment will be made during the following year to compensate beneficiaries who received adjustments in prior years on the basis of the lower wage increases. These supplemental payments would be made only to the extent that sufficient funds are available over those needed to maintain a fund balance of 32 percent. Although the administrative provisions to implement this recommendation have not been fully worked out by the Social Security Administration, it is clear that the recommendation will cause additional recordkeeping and administrative problems. For example, the supplemental COLA payment provision would require Social Security to perform a major redesign of its already troubled automated payment system.
Finally, should the automatic COLA modification recommended by the Commission be favorably considered, the Congress may wish to make it available before 1988, especially in view of the trust funds' serious financial needs. Should the economy not perform as anticipated under assumptions used by the Commission, the mechanism to provide COLAs based on the lower of the increase in prices or wages may be needed earlier than the 1988 date recommended.

Short-Term Worker Windfall

The Commission proposed limiting social security benefits for those who also have pensions from noncovered employment. The Commission's recommendation, to become effective after 1983, is designed to more directly correlate benefits payable with the proportion of time spent in employment covered by social security and the taxes paid. In April 1981, GAO reported 1/ on this problem and presented its suggestions for computing benefits which would end the advantage for all short-term workers. Assuming any modification would become effective for workers first eligible in calendar year 1984 and later, over a six-year span savings could range from $3.5 billion to in excess of $4.1 billion. The Commission recommendation will result in savings of $200 million through 1989.

1/ Attachment 1 to this statement provides further details on GAO's study on the short-term worker.
Requiring a different benefit calculation for those with pensions from noncovered employment would place additional administrative requirements on SSA for identifying such individuals and their noncovered pension amounts. It could also result in those with a small social security benefit having that benefit reduced because of a very small noncovered pension.

OBSERVATIONS ON TAXING BENEFITS

The National Commission recommended that, beginning in 1984, 50 percent of social security benefits be considered income taxable for persons with adjusted gross incomes (before including any social security benefits) of $20,000 if single and $25,000 if married. The recommendation made by the Commission presents the following potential problems:

1. "The Notch Problem" - The question of fairness is raised by establishing a specific dollar limit above which people would be taxed, such as $20,000 single and $25,000 married. The notch occurs when people have incomes just at that level or a little higher and are taxed on one half of their benefits, whereas people who have incomes just below those levels are not taxed.
2. "A Marriage Penalty" - As recommended by the Commission, a single person would be allowed $20,000 in income before being taxed on social security benefits, whereas if that individual is married, the couple can exclude only $25,000 from their combined income. The marriage penalty involves not providing an equal amount for both spouses or a $40,000 exclusion.

SSA ORGANIZATION AND MANAGEMENT

Notwithstanding the short- and long-term financing and policy issues confronting Social Security, there is another important set of issues that involve the organization and management of the social security system. Over the past 10 years, SSA has had eight Commissioners or acting Commissioners and has undergone three reorganizations. During this period, GAO has been reviewing Social Security management and program activities and noted an increasing level of criticism of its ability to pay benefits to the right people, in accurate amounts, and in a timely manner.

The organization and the management of SSA is an important aspect of effectively carrying out the social security program. The National Commission did not look into the various complex issues associated with the organization of Social Security, but a majority of its members recommended that a study group be formed to look into this matter.
In this regard, GAO will continue to place a heavy emphasis on reviews and studies directed at how well SSA is organized and managed to carry out its mission and will work closely with Social Security and the cognizant authorizing and oversight Committees of the Congress to bring about a more efficient and effective Social Security Administration.

- - - -

In closing, should the Congress decide to consider proposals, in addition to the recommendations made by the National Commission, GAO offers three options, which are briefly described in the attachments to this statement, for bringing about further savings to the trust funds. The options were developed through individual GAO studies and are offered, not as substitutes for the recommendations by the Commission, but as additional actions that the Congress might consider to improve the financial stability of the social security trust funds.

Attachments - 3
REVISING SOCIAL SECURITY'S BENEFIT FORMULA
WHICH FAVORS SHORT-TERM WORKERS
COULD SAVE BILLIONS

The social security benefit formula is a compromise between the objectives of individual equity and social adequacy; the first a reasonable relationship between taxes paid and benefits received, the second a welfare attempt to assure everyone of a basic income level.

The benefit formula provides individual equity by relating benefits to the earnings on which taxes are paid. This relationship is modified to achieve social adequacy goals by weighting the formula in favor of workers with low average earnings.

These modifications, however, have the unintended result of offering the same favorable return on payroll taxes to those who worked intermittently under covered employment as to those who worked under social security throughout their lives at low wages. And it can be—and often is—the case that the intermittent or short-term worker does not have the same need as the life-long low wage earner.

GAO has offered its suggestions for revising the benefit formula to remove this advantage. Assuming any modification would become effective for workers first eligible in calendar year 1984 and later, over a six-year span the suggestions would save between $3.5 billion and $4.1 billion.

The Department of Health and Human Services had no comments on these revisions when they were offered in GAO report HRD-81-53, issued April 14, 1981.
SOCIAL SECURITY BENEFITS PAID
TO ALIENS ABROAD AND ALIENS WHO
WORKED ILLEGALLY WHILE IN THE U.S.

Congressional concerns have surfaced repeatedly since the early days of the social security program about the inequity that might be worked upon the American social security taxpayer by aliens who work only long enough to become eligible, then retire to their native countries to collect benefits for themselves and their dependents.

GAO found these concerns valid. We found that more than 60 percent of beneficiaries abroad are aliens and that alien retirees abroad generally have worked less time in covered employment, paid less taxes to social security, and have more dependents than does the average retiree, frequently adding such dependents after retirement. Millions of dollars could be saved by curtailing benefits to aliens, but the amount of savings is dependent on which of several options is selected.

GAO cautions, however, that the alien question presents a number of difficult and complex policy issues. The issues involve (1) the equity of treating aliens differently than Americans, (2) the potential international reaction by countries whose citizens will be adversely affected, and (3) the administrative question of requiring aliens to pay full FICA taxes and then placing a cap or other curtailment on their benefits.

GAO also notes that a gap exists between the provisions of the Social Security Act and the Immigration and Nationality Act (INA) which allows aliens to earn entitlement to social security
benefits while violating the INA. Consequently, millions of aliens, both legal and illegal, may have engaged in unauthorized employment and earned entitlement to social security benefits for such employment. Correction of the gap through legislation could, by relatively conservative estimates, save the trust funds perhaps $1 billion each year.
DISCONTINUING SOCIAL SECURITY'S CURRENTLY INSURED BENEFIT PROVISION WOULD SAVE MILLIONS AND ELIMINATE INEQUITIES

GAO recommended that social security's currently insured benefit provision be discontinued because it is irrelevant and inequitable. Discontinuance will not affect survivors now receiving benefits and could, through 1990, save the trust funds about $180 million.

About 99 percent of all insured workers earn retirement and death protection for their survivors by becoming fully insured—a status reached by having one quarter of coverage for each year after 1950 or age 21 and before the year of death or age 62. An alternate path to eligibility, the currently insured provision, requires the worker to have only six quarters of coverage during the 13-quarter period ending with the quarter in which death occurs.

The currently insured provision, enacted in 1939 to provide backstop protection during the program's early years for the families of those workers who might die before they had a chance to work long enough to become fully insured, is no longer needed. Today, 9 out of 10 jobs are covered by social security, and the vast majority of workers are fully covered. Further, over the years the coverage requirements to obtain and retain full protection have been eased so that there is no longer the same need for an alternate path to eligibility.

The Department of Health and Human Services has supported the proposed elimination of the currently insured provision, as offered in GAO report HRD-82-51, issued April 23, 1982.