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RELEASED

Financial Problems Confront The Federal Old-Age And Survivors Insurance And Disability Insurance Trust Funds

Social Security Administration

Department Of Health, Education, And Welfare

These social security trust funds face exhaustion in the near future because of increasing benefit levels and high unemployment. They will also incur a large long-range deficit because of lower fertility rates and the rising cost of living.

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

MWD-75-105 906491 JULY 25, 1975

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164031(4)

The Honorable Lester L. Wolff
House of Representatives

Dear Mr. Wolff:

As you requested, we are reporting on the financial status of the Federal Old-Age and Survivors Insurance and Disability Insurance trust funds.

Since the information in this report was derived from material published by the Department of Health, Education, and Welfare and other sources, we agreed not to obtain their comments.

We believe the report would be of interest to committees and to other Members of the Congress.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

CPI	Consumer Price Index
DI	Disability Insurance
GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
OASDI	Old-Age and Survivors Insurance and Disability Insurance
OASI	Old-Age And Survivors Insurance
SSA	Social Security Administration

COMPTROLLER GENERAL'S REPORT TO THE HONORABLE LESTER L. WOLFF, HOUSE OF REPRESENTATIVES

FINANCIAL PROBLEMS CONFRONT THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS

Social Security Administration
Department of Health, Education, and Welfare

DIGEST

The Federal Old-Age and Survivors Insurance and Disability Insurance trust funds face exhaustion in the near future because of increasing benefit levels due to inflation, and high unemployment causing reduced contributions to the social security system. (See p. 4.)

Projections covering the next 75 years show that the system will also incur a large long-range deficit because of the decreasing fertility rate in the United States and the rising cost of living. (See pp. 4 to 6.)

Various sources have made many recommendations to help the Congress alleviate the fiscal problems the system faces. The recommendations cover a wide range of ideas from raising social security taxes to financing the Medicare program from general revenue and using the present Medicare taxes to help finance the other social security programs. (See pp. 16 to 18.)

If the Congress accepts the recommendations regarding changes to the present benefit computation formula and the funding of Medicare by general revenue, the short-range problems of the trust funds should be alleviated and the magnitude of the long-range problems should be substantially reduced. However, if the Congress chooses not to accept them, there may be no alternative to increasing taxes for these social security trust funds. (See pp. 16 and 17.)

MWD-75-105

Tear Sheet. Upon removal, the report cover date should be noted hereon.

CHAPTER 1

INTRODUCTION

At the request of Congressman Lester L. Wolff, we examined the financial condition of the social security system's Federal Old-Age and Survivors Insurance and Disability Insurance (OASDI) trust funds. These trust funds, plus two other 1/ whose financial condition has not been questioned, are held by a Board of Trustees which, by law, is composed of the Secretaries of the Treasury; Labor; and Health, Education, and Welfare (HEW). The Commissioner of the Social Security Administration (SSA) also serves as Secretary of the Board of Trustees.

The Federal Old-Age and Survivors Insurance (OASI) trust fund was established on January 1, 1940, to hold the amounts accumulated under the OASI program. The Social Security Amendments of 1956, which became law August 1, 1956, provided for the creation of the Federal Disability Insurance (DI) trust fund--a fund separate from the OASI trust fund--to hold amounts accumulated under the DI program.

The major source of receipts for these two funds is contributions paid by workers and their employers, and by individuals with self-employment income, for employment covered by social security. Nine out of 10 workers in the United States contribute to the social security programs. Trust fund money not needed for current benefits and administrative expenses is invested in interest-bearing Federal securities.

In fiscal year 1974 contributions to the OASDI trust funds totaled about $55 billion, benefits paid out totaled about $54 billion, and the balance of the trust funds totaled over $46 billion.

The principal source of published information on the financial condition of the OASDI trust funds is the Annual Report of the Board of Trustees sent to the Congress as required by the Social Security Act. The most recent is the one for 1975--representing the 35th such report.

1/In addition to the OASDI trust funds, there are two other social security funds, the Federal Hospital Insurance trust fund and the Federal Supplementary Medical Insurance trust fund. They hold money used to finance health insurance benefits pursuant to the Medicare provisions of the Social Security Act.

We reviewed the 1973, 1974, and 1975 trust fund reports and the following additional sources of information on the trust funds:

--Reports of the Advisory Council on Social Security, dated March 6, 1975. The Social Security Act provides that the Secretary of HEW appoint an advisory council every 4 years to review the status of the four social security trust funds.

--The Report of the Panel on Social Security Financing to the Committee on Finance, United States Senate, pursuant to Senate Resolution 350, 93d Congress, dated February 1975. The Committee requested the examination as a result of statements made in the 1974 trust fund report regarding projected long-range deficits.

--"An Actuarial Audit of the Social Security System," dated September 1974 by Robert S. Kaplan and Roman L. Weil, a report for the Secretary of the Treasury.

--"Social Security: A Sound and Durable Institution of Great Value," a paper dated February 1975 by five former HEW Secretaries and three former SSA Commissioners.

--The Report of the Subcommittee on Finance of the Advisory Council on Social Security dated February 3, 1975.

--Long-Range Cost Estimates for Old-Age, Survivors, and Disability Insurance System, 1974-U.S. Department of Health, Education, and Welfare Actuarial Study No. 73, dated September 1974.

--Numerous articles published in newspapers and periodicals (including the Wall Street Journal article dated July 15, 1974, which was referred to in Congressman Wolff's request).

The information in this report was derived from the above listed material, which has been published by HEW or other sources. It was agreed with Congressman Wolff's office that their comments on the report would not be obtained.

CHAPTER 2

FINANCIAL STATUS OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS

The 1974 trust fund report, which was transmitted to the Congress in May 1974, alerted the Congress and the public to the possibility of long-range problems in maintaining the financial solvency of the OASDI trust funds. The 1975 trust fund report reemphasizes these problems and projects a deficit much larger than projected in the 1974 report. These problems will result mainly from a downward trend in the Nation's birth rate and increases in the Consumer Price Index (CPI), a measure of the cost of living. Although the 1974 report did not warn of serious problems in the near future, studies by other groups published subsequent to this report, while agreeing with the 1974 reports' long-range prognosis, warned that the trust funds are nearing exhaustion. The 1975 trust fund report states that the trust funds will be exhausted soon after 1979, due mostly to current trends of high unemployment and rapidly rising prices which cause lower contributions and large increases in benefits. It concludes that steps should be taken soon to insure the trust funds' financial integrity and soundness.

The 1975 trust fund report contains both short- and long-range estimates of the financial status of the trust funds. The short-range estimates cover from July 1974 through December 1979, and the long-range estimates cover from 1975 through 2049.

FACTORS AFFECTING THE SHORT-RANGE STATUS OF THE TRUST FUNDS

Under existing law, social security benefits increase on the basis of rises in the CPI. In each year that immediately follows a year in which an automatic benefit increase becomes effective, the taxable earnings base will be automatically increased on the basis of the percentage increase in average covered wages. In 1975 the base was increased from $13,200 to $14,100. The increases in the taxable earnings base are expected to help pay for the increased benefits.

Therefore, the short-range estimates are prepared assuming certain projected increases in benefits and in the taxable earnings base. The 1974 report predicted no serious financial problems for the years 1974-78. However, the increased unemployment rate causing decreased contributions to the trust funds, coupled with a much higher than anticipated CPI causing increased outflow--in the form of higher benefits--from the trust funds, have combined to bring about a serious problem in the short-range status of the trust funds. Consequently, the 1975 report states that without additional financing the trust funds' assets will be exhausted soon after 1979.

Table 1, prepared using information in the 1975 trust fund report, shows the substantial decline in the assets during 1975 to 1979.

Table 1

Estimated Balances of the OASI and DI Trust Funds in Calendar Years 1975-79

Year	Balance OASI	DI	Combined
	(billions)		
1975	$35.6	$7.3	$42.9
1976	31.3	5.8	37.1
1977	27.3	4.0	31.3
1978	23.0	2.4	25.4
1979	18.2	0.4	18.6

FACTORS AFFECTING THE LONG-RANGE STATUS OF THE TRUST FUNDS

The long-range estimates for the two trust funds are computed assuming that future benefit levels and the taxable earnings base will be automatically adjusted according to present law. Under these assumptions, the 1974 trust fund report projected that the two trust funds would be underfinanced over the next 75 years, with an average actuarial deficit of about 3 percent (actually 2.98 percent) of taxable payroll.1/

1/Taxable payroll is that part of earnings which (1) results from employment covered by the social security system and (2) is within the current statutory taxable earnings base for social security purposes. The 1975 taxable earnings base is $14,100; all earnings for an individual up to this amount are subject to withholding of social security contributions. Current contribution rates for the Old-Age Survivors and Disability Insurance trust funds as a percent of taxable payroll are 4.95 percent each for an employee and his employer and 7 percent for self-employed individuals.

The 1975 trust fund report projects the long-range deficit to be 5.32 percent of taxable payroll. This underfinancing is applied approximately three-fourths to the OASI and one-fourth to the DI programs.

Demographic assumptions

The 1974 report showed a substantial deterioration in the financial status of the trust funds from that shown in the 1973 report. This was due mainly to the use of revised demographic (population) assumptions. New population projections were prepared on the basis of the results of the 1970 census and with the assumption of significantly lower future fertility rates, which substantially affected the actuarial balance. A lower fertility rate results in a higher projected ratio of aged persons to workers and, therefore, in a higher ratio of costs to income for the programs. The 1973 report projected an average actuarial deficit of 0.32 percent of taxable payroll over the long range. The population projections used in the 1974 report accounted for an additional deficit of 1.87 percent of taxable payroll, representing the major cause of the radical change in the projected status of the trust funds between the 1973 and 1974 reports.

The 1975 report is based on fertility rate assumptions which are lower than those used in the 1974 report. It is noteworthy that the Panel on Social Security, in its report to the Senate Finance Committee, chose to use fertility rate assumptions slightly lower than those in the 1975 report. (See table 2.) The 1975 report states that fertility rates will decline through 1977, bottoming at 1.7, 1/ and then slowly rise to a level of 2.1 2/ in the year 2005. This level will then be maintained for the remainder of the long-range period.

1/Fertility rates are measured by the average number of babies each woman in the United States is expected to have during her lifetime.

2/According to the 1975 trust fund report, a fertility rate of 2.1 babies per woman is close to the population replacement rate and would ultimately result in close to zero population growth.

Table 2

Projected Fertility Rates

	1975	1980	1990	2000	2025	2050
1974 trust fund report	1.9	2.0	2.1	2.1	2.1	2.1
1975 trust fund report	1.8	1.76	1.98	2.1	2.1	2.1
Panel report	1.9	1.6	1.8	1.9	2.1	2.1

Source: Social Security Administration actuarial staff and the Panel report.

The major impact of lower fertility rates is expected to occur after the turn of the century.

Economic assumptions

The 1974 report showed a serious deterioration in the long-range status of the trust funds from that projected by the 1973 report. This was due mostly to changes in demographic assumptions. The 1975 report shows a deterioration (2.34 percent of taxable payroll) in the long-range status of the trust funds from that projected in the 1974 report, but this change is due mostly (83 percent) to changes in economic assumptions.

The 1974 report assumed that annually, average wages would increase over the long range by 5 percent and that the CPI would increase by 3 percent. The 1975 report uses 6 and 4 percent, respectively, as its central set of economic assumptions. The report also provides cost estimates using two other economic assumptions, 5 percent/3 percent and 7 percent/ 5 percent, to show the impact on the deficit if economic conditions were not as expected over the long range. The report cautions that any projections of program costs are highly sensitive to variations in the assumptions, and that there is a high degree of uncertainty in long-range economic forecasts.

As shown in table 3, the projected deficit changes substantially depending on what set of assumptions are used. The 1975 report and the Panel report agree that the 6 percent/ 4 percent should be used for a central set of economic assumptions.

Table 3

Impact on Total Trust Fund Deficits
Using Alternative Sets of
Economic Assumptions

Alternative economic assumptions for wages/CPI (note a)	Projected deficits computed using information contained in: 1974 trust fund report	1975 trust fund report	Panel report
	(as a percent of taxable payroll)		
5/3	b/2.98%	3.99%	3.9%
6/4	4.29%	b/5.32%	b/6.0%
7/5	6.14%	6.74%	7.3%

a/Expressed as expected annual percentage increases. For example, 5/3 represents an assumption of an annual 5 percent increase in average wages and 3 percent increase in the CPI.

b/Projected deficit anticipated by respective report.

Overall findings and recommendations of the Board of Trustees in the 1975 trust fund report

The short-range actuarial cost estimates indicate that the assets of the OASDI trust funds will decline during 1975-79, and will be exhausted soon after 1979. The Board believes that the required additional income to the trust funds should be obtained through increases in the tax rate, in the taxable earnings base, or in both. It opposes the use of additional general revenue financing for the OASDI programs.

The long-range actuarial cost estimates indicate that for every year in the future, the expenditures will exceed the income from social security taxes. This excess is estimated to annually average about 1.3 percent of taxable payroll over the next 25 years (1975-99). After the turn of the century, the excess will become substantial. The report explains that, to some extent, this is due to unintended results in the automatic benefit adjustment provisions enacted in 1972 which cause future projected benefits to increase out of proportion to levels of wage replacement established by benefits currently paid under the program. The Board concurs with the intent of the recommendation by the 1975 Advisory Council on Social Security that the benefit structure be revised to maintain the levels of benefits in relation to preretirement earnings levels that now prevail. (See p. 9.)

The Board also concurs with the Advisory Council recommendation (see p. 9) that the OASDI tax rate applicable to self-employment income be set at a level equivalent to 150 percent of the tax rate applicable to wages.

Report of the Advisory Council on Social Security

Pursuant to provisions of the Social Security Act, the Advisory Council on Social Security is appointed by the Secretary of HEW every 4 years to review the status of the four trust funds. The Council last reported its findings and recommendations regarding the changes needed in the system to the Secretary in March 1975.

The Council made the following four "cash benefit" recommendations aimed at solving the OASDI trust funds' fiscal problems.

1. The provision of the retirement test 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, and replaced with one based strictly on annual earnings. This would eliminate payment of benefits to those persons who are able to channel their yearly earnings into a few months and establish benefit eligibility for the rest of the year.

2. The minimum benefit should be frozen at a specified level and benefits should not exceed 100 percent of the earnings on which the benefit is based. This is aimed at workers who are eligible for retirement benefits under both social security and other retirement programs (for noncovered employment). It is viewed as a windfall to these individuals because benefits they will receive are out of proportion to what they contribute.

3. Make universal coverage compulsory. This would expand coverage to those with earnings not now covered--mainly from public employment. The Council feels such a change would eliminate unwarranted duplication of benefits.

4. The benefit structure should be revised to maintain levels of benefits in relation to preretirement earnings levels that now prevail. This is known as decoupling. The provision of the 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. 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.

The Council made the following four "financing" recommendations.

1. The cash benefits program needs a small amount of additional financing immediately to maintain the trust funds' levels. In about 2005 the program will face serious deficits. Steps should be taken soon to assure the financial integrity and long-range financial soundness of the program.

2. No increase should be made in the total tax rates for employees and employers for OASDI and hospital insurance beyond those already scheduled in present law. 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 and, therefore, should be phased out of support from the payroll tax.

3. The present 7-percent limit on the tax rate for the self-employed should be removed. The self-employment OASDI tax rate should be 150 percent of the employee contribution rate as it was at the time the self-employed were first covered. This would raise the tax rate to 7.425 percent.

4. An increase in the retirement age might merit consideration by the Congress in the next century. In later years, as the proportion of retirees to workers

increases greatly, such a change may be necessary as the burden on people still working may become excessive.

Report of the Panel on Social Security Financing

After the 1974 trust fund report was published, the Senate Finance Committee appointed the Panel on Social Security Financing to provide the Committee "an expert, independent analysis of the actuarial status of the social security system." The February 1975 report of the Panel, pursuant to Senate Resolution 350, 93d Congress, contains three findings and general recommendations which we have summarized below.

--Finding: The actuarial status of the OASDI system is unsatisfactory.

Recommendation: Strong measures should be taken to restore the financial stability of the OASDI program.

The Panel reviewed the assumptions made by the Board of Trustees in the 1974 trust fund report which led to their projection of a deficit for the trust funds of approximately 3 percent of taxable payroll over the next 75 years. Using its own set of assumptions, the Panel estimated a 6-percent deficit for the same period. It noted that the most difficult assumptions to forecast accurately--fertility rates, wage patterns, and cost-of-living indexes--have the greatest relative impact on the long-range status of the trust funds. While the Panel states that the estimates used in the 1974 trust fund report are reasonable, it believes their own assumptions, where they differ, are more realistic. The two major differences in assumptions are (1) the Panel assumes a much lower fertility rate for 1980 thru 2000 than assumed in the 1974 report and (2) it assumes annual increases for average wages and the CPI of 6 and 4 percent, respectively, compared to the 1974 report assumption of 5 and 3 percent.

--Finding: The present formula for determining benefit awards at retirement responds irrationally to changes in the rate of inflation.

Recommendation: The benefit structure should be changed to eliminate this type of response.

Under current law an individual's initial retirement benefits are indexed to increases in both the CPI and his average monthly earnings before retirement. The "irrational" response is manifested in an "over-indexing" of wages with some retirees experiencing replacement ratios of over 100 percent of their earnings just before retirement. This happens because it is possible for the CPI to increase by varying rates while the real wage 1/ rate increases remain constant (providing average wage increases change at the same rate as the CPI). The replacement ratios under such a situation fluctuate sharply upward or downward, especially for workers with low and medium incomes. The Panel feels the problem could be corrected by indexing benefits to increases in either the CPI or in average monthly earnings, but not to both. This method is sometimes called decoupling.

--Finding: The present methodology for forecasting and analysis purposes is inadequate for the system's magnitude and complexity.

Recommendation: Improved procedures should be adopted to reveal the costs, implications, and controllability of the program.

The Panel believes that better projection methods are in existence, which, if adopted, could easily remedy the shortcomings of the current method. A more thorough use of computer capabilities to simulate the system, as has been done in public and private programs, is the solution proposed by the Panel for this portion of SSA's problem.

In summary, the Panel concluded that the trust funds' long range financial problems are far more serious than its short range ones. However, the Panel stated that the present trust funds will be seriously eroded in the years immediately ahead and will be exhausted by the late 1980s unless the benefit structure of the social security system is overhauled in the near future and additional financing is provided. The Panel's report contains no specific proposals for removing or narrowing the expected financial gap, because the Panel believes that such proposals are outside their responsibility.

1/Real wages is the difference between the annual rates of increase in average annual wages and the CPI.

CHAPTER 3

DISCUSSION OF STATEMENTS MADE IN THE

WALL STREET JOURNAL

In general, the Wall Street Journal article, mentioned by Congressman Wolff, and the 1975 trust fund report agree regarding the overall short- and long-range financial condition of the trust funds. However, the Journal chooses to express the average long-range deficit for the trust funds in money amounts which are in billions of dollars, while the trust fund report expresses the deficit as a percent of taxable payroll which amounts to 5.32 percent. To an uninformed reader, the Journal's method of presentation may make the deficit appear much larger than it does when expressed as a percent of taxable payroll.

PROJECTED DEFICIT FOR THE TRUST FUNDS

The Journal states "that by 1990, even though a worker pays a maximum Social Security tax of $2,070.45 * * * the system will be paying out $20 billion more in benefits than it takes in that year." The $20 billion is a figure acquired from one of SSA's actuaries by a reporter of the U.S. News and World Report magazine. It was not published in, nor can it be calculated from, information contained in the trust fund report. It results from an unofficial social security estimate that by 1990, the trust fund deficits will equal about 1 percent of the projected $1.8 trillion taxable payroll in that year.

At the time of the Journal's article, the social security estimate for the maximum contribution amount to be paid in 1990 was $2,051.10. This represents nearly a 150 percent increase over the maximum amount of $824.85 paid in 1975. However, it should be noted that the $2,051.10 will be paid by persons earning $31,800 (the maximum taxable earnings level) or more in 1990 and will represent 6.45 percent of their taxable income--only a 0.6 percent increase in the contribution rate over the 5.85 percent rate now in effect. This increase will be due solely to several projected increases in the health insurance contribution rate between now and 1990.

According to the 1975 report, average earnings will increase at an annual rate of 6 percent. An individual earning $14,100 a year in 1975 (the present maximum taxable earnings level) will earn about $33,880 by 1990--or $2,000 more than the maximum taxable earnings level planned for that year. Considering the significant increase expected in annual incomes and the somewhat static contribution rate planned, there is little relative difference in the tax on an individual's earnings between now and 1990.

UNFUNDED LIABILITY FOR THE TRUST FUNDS

The $2.1 trillion unfunded liability quoted in the Wall Street Journal article was calculated by the Office of the Actuary of SSA and appears in the Statement of Liabilities and Other Financial Committments of the United States Government as of June 30, 1973, issued by the Department of the Treasury. The amount of the liability has increased from $2.1 trillion to $2.5 trillion as of June 1974.

In House Report No. 92-231, dated May 26, 1971, the House Committee on Ways and Means stated that:

> "The concept of actuarial soundness as it applies to the old-age, survivors, and disability insurance system differs considerably from this concept as it applies to private insurance and private pension plans * * *. In connection with individual insurance, the insurance company or other administering institution must have sufficient funds on hand so that if operations are terminated, it will be in a position to pay off all the accrued liabilities. This, however, is not a necessary basis for a national compulsory social insurance system * * *.
>
> "It can reasonably be presumed that, under Government auspices, such a social insurance system will continue indefinitely into the future. The test of financial soundness, then, is not a question of whether there are sufficient funds on hand to pay off all accrued liabilities. Rather, the test is whether the expected future income from tax contributions and from interest on invested assets will be sufficient to meet anticipated expenditures for benefits and administrative costs over the long-range period considered in the actuarial evaluation."

The Committee believed that the concept of an unfunded liability did not have the same significance for a social insurance system as it did for a plan established under private insurance principles. The Board of Trustees has chosen not to disclose the unfunded liability in its annual report on the status of the trust funds.

DYNAMIC ASSUMPTIONS AFFECTING THE TRUST FUNDS

According to the Wall Street Journal, the total trust fund deficits for the 75-year projection period will be $62 billion, computed using the "dynamic assumptions" definition of actuarial soundness. These dynamic assumptions include projections of birth rates and the growth in real wages. The article goes on to challenge the 1973 trust fund report's assumptions regarding both of these, stating that the estimates are too high. The Journal believes that these "errors imply much higher taxes are required to sustain benefit levels."

The $62 billion quoted is not the correct estimate of the deficit for both trust funds under the dynamic assumptions because (1) it was calculated using the economic and demographic assumptions in effect on June 30, 1973, that are no longer considered valid and (2) it did not include a projection for the DI trust fund. On June 30, 1973, the projected long-range deficit for the combined funds was $176 billion or about 0.32 percent of taxable payroll. As of June 30, 1974, the projected deficit had increased to $1.3 trillion or 2.98 percent of taxable payroll over the 75-year, long-range period. This figure may imply the need for higher taxes; however, how much higher depends on the extent to which the Congress uses alternative methods for either increasing revenue or decreasing outlays of the trust funds.

The assumptions in the 1974 and 1975 trust fund reports regarding future birth rates and future increases in average wages and the CPI are quite a bit different from the assumptions in the 1973 report--bringing them closer to recent experience. The new lower fertility rates will result in increased costs as a percentage of payroll because the number of future workers will decrease before the number of future retirees. Therefore, total taxable payroll would be reduced before benefits are affected.

The 1974 and 1975 reports provide for a 2-percent annual growth in real wages (increase in average wages less the increase in the CPI) instead of the 2-1/4 percent growth rate in the 1973 report. Since the annual growth rate for the 10-year period ending in 1973 was only 1.17 percent, the new assumptions are moving in the direction of recent experience. However, if the growth rate is lower than expected, the cost of the system as a percentage of taxable payroll will be higher than expected.

In summary, the Wall Street Journal did not agree with the economic or demographic assumptions used in the 1973 trustees report. However, there have been considerable changes to these assumptions by the trustees as evidenced by the 1974 and 1975 reports. These changes are in the direction advocated by the Journal.

Any long-range assumptions about fertility rates and economic conditions are, by nature, open to criticism. However, the Journal article and the 1974 and 1975 trust fund reports do share the prognosis that the trust funds face a serious financial deficit over the next 75 years and that changes in the social security system will be necessary to meet future benefit levels. It seems evident that regardless of the disagreements concerning the assumptions underlying reports written recently on the status of the trust funds, all of these reports indicate substantial financing problems for the funds.

STATEMENT MADE IN THE KAPLAN AND WEIL STUDY ON THE STATUS OF THE SOCIAL SECURITY TRUST FUNDS

The Journal states that "The assumptions * * * of the Social Security Administration are obsolete and ridiculously optimistic" and adds that the Kaplan and Weil study (made by university professors hired by the Department of Treasury to study the trust funds) states that, realistic assumptions "imply taxes 50% to 75% higher than current levels."

The aforementioned study is based primarily on the 1973 Annual Report of the Board of Trustees which, as mentioned earlier, contains assumptions which are quite different from those contained in the 1974 and 1975 reports. The new assumptions are much closer to those made by Kaplan and Weil. On the basis of data in the 1974 report, it can be derived that the OASDI program costs, as a percent of payroll, were expected to increase 67 percent from 1974 to 2045. However, while this increase may bear some relationship to the statement made by Kaplan and Weil, it cannot realistically be assumed that taxes alone will be adjusted to compensate for the increase in costs.

CHAPTER 4

CONCLUSIONS AND OBSERVATIONS

All of the groups mentioned in this report generally agree about the existence of a large, long-range deficit for the trust funds. Most of these groups also recognize the possibility of an exhaustion of the trust funds in the near future. They all suggest the need for timely action to reduce or alleviate the deficits, and some have suggestions for corrective actions. Most of the suggestions would help alleviate both the long- and short-range problems of the trust funds.

Complicating solutions to the problems is the fact that long-range actuarial estimates are very sensitive to both demographic and economic assumptions.

Although the assumptions made in the 1975 report generally agree with those of the Panel on Social Security Financing, both recognize the inherent uncertainty of these types of assumptions. If these assumptions prove to be even marginally incorrect, the status of the trust funds could be substantially different from that which has been estimated.

The Board of Trustees, the Advisory Council, and the Panel on Social Security Financing agree that the present method for calculating initial retirement benefits should be "decoupled" (see pp. 7 to 11) as the first step toward alleviating the long-range problems of the trust funds. The present double advantage to new and future retirees may not have been intended by the Congress, and its continuance is costly to the trust funds.

Secondly, the Advisory Council recommends that the Congress increase the tax rate applicable to the OASDI programs by maintaining the overall tax rate at its present level (5.85 percent) and gradually funding increasing amounts of the health insurance (Medicare) program costs out of general revenues. It also recommends that presently scheduled increases for the health insurance tax rate totaling about 1.2 percent through 1986 should continue to be enacted, but used as additional financing for the OASDI programs.

As part of its justification for the public funding of Medicare, the Advisory Council report states

> "* * * to the extent that general revenues are derived from progressive taxes, those in the lower economic groups would almost certainly

benefit from the shift of the hospital insurance tax to general revenues. These groups include the persons that would have the greatest difficulty in handling a * * * increase in the social security tax. For many of them that tax is already a greater burden than the income tax."

If the Congress accepts the recommendations regarding decoupling and Medicare funding, the short-range problems of the trust funds should be alleviated and the magnitude of the long-range problems should be substantially reduced.

However, if the Congress chooses not to accept these recommendations, there may be no alternative to increasing taxes for the OASDI programs. In this case, a combined increase in both the contribution rate and the earnings base could be a solution to the short- and long-range fiscal problems of the trust funds.

On pages 12 and 13, we discussed the maximum contribution amount paid by individuals both today and in 1990. After an allowance for expected increases in the average income for the 15-year period and projected increases in the taxable earnings base, we determined that, in fact, individuals will be paying virtually no greater portion of their earnings for OASDI program coverage in 1990 than they do today. It is obvious that the Board of Trustees is attempting to cope with an increasing projected deficit when the rate of contributions from taxpayers is being held constant. The costs (in the form of benefits) of the social security programs are automatically increased due to rises in the cost of living. To be in balance, the income to the programs should be raised to offset these increased costs.

A combination of an increased tax rate and a rise in the taxable earnings base would help assure that the burden of the needed increase is not borne disproportionately by one income group. Apparently, an increase in the tax rate has the greatest effect on lower income groups because it probably applies to all of their earnings. An increase in the taxable earnings base affects only those individuals earning more than the previous base amount. The result of the combination increase helps to keep the amount of the needed increase in both elements to a minimum and could spread the impact of the increase more evenly to all income groups.

The Advisory Council recommendation--that the present retirement test should be revised so that it provides for an annual earnings test only--would eliminate the payment of retirement benefits to individuals who are substantially employed.

The acceptance of these recommendations by the Congress, in whole or in part, will determine the amount of reliance which must be placed on alternative actions to eliminate the trust funds' projected deficits. Some of these recommendations are (1) slowing down the planned automatic benefit increases or entirely eliminating them, (2) raising the eligible retirement age, (3) freezing the minimum retirement benefit, and (4) seeking new contributors to the social security system.