Social security changes necessary

According to the most recent estimates of the trustees of the Social Security Trust Funds, expenditures for old age, survivors, and disability benefits will exceed income by about $5.6 billion during 1977. This is substantially higher than the $3.9 billion deficit that the trustees forecast one year ago. The trust fund for disability payments is expected to be exhausted in 1979, and the trust fund for old age and survivors benefits in 1983, unless something is done to increase the income of these funds in the near future. Furthermore, the problem is not simply short-ranged and caused by the recent high levels of unemployment and inflation. The social security system will have progressively increasing deficits year after year unless changes are made in the method of financing, the system for determining benefits, or both. The trustees estimate that over the next 75 years the average tax rate will have to be about 75 percent higher than the rate (including scheduled increases) provided for by current law to balance revenues and benefit payments.[1]

Automatic benefit increases

Before the 1972 overhaul of the social security system,[2] Congress had intermittently passed legislation altering the benefit and tax schedules. The increases in benefits generated by this earlier legislation were significantly larger than the inflation that occurred between changes. Nevertheless, the income to the trust funds had provided an ever-increasing balance in the trust fund. In 1972 legislation that provided for an automatic escalation of benefits determined by increases in the Consumer Price Index was passed. At the same time the level of wages subject to the payroll tax was tied to increases in the average wage.

Application of the new formula raised current benefit payments very sharply in the midst of the recession. At the same time, although the wage base was also increased, the rate at which tax receipts were rising dropped significantly because of the high levels of unemployment. This immediate impact was not foreseen at the time the legislation was passed, although some longer-run shortage of income was anticipated. The 1973 forecast of the trustees expected revenues to still be running ahead of benefit payments in 1977.

In addition to the short-term financing problem posed by the continuation of high unemployment and high inflation, a recent Supreme Court decision has increased the benefit payment more rapidly than could have been expected when the 1972 legislation was passed. The new ruling awards widowers the right to claim full dependency benefits without proof of dependency—a right previously available only to widows.

The long-term problem

A significant part of the long-term problem results from the 1972 changes incorporating automatic increases in both wage base and benefits and the way in which benefits are computed. The payments to each new retiree are based on an average of the wages on which taxes were paid. Each time the base for collecting taxes is raised, the level

[1]This estimate is for old age, survivors, and disability programs only. Problems of a long range nature also exist for the Hospital Insurance Trust Fund if hospital costs continue to rise at the 15 to 16 percent annual rates experienced in recent years.

[2]While financing problems, over both the short and long term, beset all aspects of the social security system, this discussion is primarily centered on old age and survivors benefits, which account for about three-quarters of the total benefits operating with payroll-tax financed trust funds.

of benefits for future retirees is also raised. But the levels of benefits for each average wage level are also raised because of the adjustment for the change in the Consumer Price Index. Thus, while current beneficiaries have their payments raised in step with inflation, the inflation correction for future retirees is made twice. This overcompensation, referred to as "coupling," accounts for about half of the long-term deficit predicted by the system trustees.

Another major cause of the projected deficit lies in the changing age distribution of the nation's population. Currently, there are over 100 million persons paying social security taxes, while 33 million are drawing benefits. If present trends continue, in 75 years two persons will be paying taxes for each individual drawing benefits. Although 75 years is a long time to project population trends, even in the somewhat shorter period to the year 2000, the demographics are unfavorable. Most persons who will have firm attachment to the labor market in the year 2000 have already been born, and the vast majority of the beneficiaries who will be receiving payments, financed by the taxes on the work force of that day, are also now alive. By that time the number of workers per beneficiary is going to drop from today's 3.1 level to about 2.6. Even if there were no change in benefits from today's levels, the tax rate needed to keep the system on a "pay as you go" basis will have to be about 20 percent higher than the present rate.

The President's program

President Carter has proposed a series of eight changes in the social security program aimed at solving both the short- and long-term financing problems. Two of these eight changes will act to decrease the rate at which benefit costs increase. The most important is "decoupling," or eliminating the double adjustment of future benefits for inflation, which would be accomplished by adjusting future benefits for wage increases only. The other change would be to narrow the eligibility for claiming benefits based on a deceased spouse's earnings to the claimant who had the lower earnings of the two, rather than having eligibility independent of the claimant's earnings, as is now the case.

Another proposed change would transfer part of the currently scheduled increases in payroll taxes (1978 and 1981) from the Hospital Trust Fund, for which these increases are now earmarked, to the Old Age and Survivors and the Disability Trust Funds. This shift assumes that the rate of growth of costs for payroll-tax financed Medicare costs will be slowed significantly in future years.

Of the five remaining proposed changes, four are direct tax increases. The most significant of these changes would require the employer to pay taxes on the entire wage rather than on the same wage base paid by the employee. The increase would be introduced in steps, reaching the full payroll level in 1981, and providing about 60 percent of the $50 billion of total funds which would be raised in the 1978-82 period if the President's proposals were adopted.

The other tax changes that are proposed include increases in the wage base by an average of $300 per year from 1979 through 1985 in addition to the automatic increases that will result from operation of the 1972 act. This procedure will raise the wage base to about $30,300 per year as compared to $27,900 without the added increase.

Another proposal is to raise the tax paid by self-employed individuals from 7.0 to 7.5 percent. Prior to the 1972 act self-employed persons paid a 50 percent higher tax rate than did wage and salaried workers. This change would restore that ratio to the historic level.

The remaining tax increase is to advance the effective date of a tax rate increase of 1 percent (on both employer and employee) which is now scheduled for the year 2011. One-quarter of the increase would become effective in 1985, the balance in 1990.

Correcting for the recession

The remaining Presidential proposal to modify the funding of the social security system is to augment social security receipts with general revenue funds when the unemployment rate is about 6 percent. The trust funds would be credited with an amount equal to the difference between what was actually paid and the estimated payments if unemployment were actually at 6 percent. This new funding, called the "counter-cyclical financing method," would make transfers in 1978, 1979, and 1980 based on the unemployment rates for 1975 through 1978. The Administration is currently asking that this method be enacted temporarily, suggesting that it be made permanent if a review in 1978 proves the method sound.

Congressional reaction

Leading members of Congress have generally agreed on the need for a prompt program to insure financing of the social security system. Virtually all who have commented have recognized the necessity of "decoupling" wage- and price-related benefit adjustments. Reaction to the other proposals has been mixed, and while some changes in the social security financing structure seem certain within the next year, they could be in directions significantly different from the President's proposal. Most adverse Congressional reaction has centered on the counter-cyclical financing from general revenues. Significant opposition to any move away from a fully self-supporting social security system seems to exist. Several Senators and Representatives have indicated they would view such a move as a change from an insurance system toward a welfare system of benefit payments.

Morton B. Millenson